No. [redacted]

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
MAR 30 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
Attorneys for Petitioner.

Of Counsel:

O'BRIEN, DRISCOLL & RAFTERY,
152 West 42nd Street,
New York, N. Y. 36.

TABLE OF CONTENTS

	PAGE
Opinions Below	2
Jurisdiction	2
Statute and Rule Involved	2
Statement of the Case	3
I—Certiorari should be granted in this case for the following reasons	4
II—Questions presented for review	5
Authorities and argument in support of questions for review	5
Lerner appreciated the importance of the November 4, 1960 resolution, yet he did not inform the seller that it had been adopted	9
Conclusion	24

TABLE OF CASES

Hughes & Co. v. SEC (C. A. 2d 1943), 139 F. (2d) 434, 436	8, 14
Kardon v. National Gypsum Co. (E. D. Pa. 1947), 83 F. Supp. 613, 614	7
Kardon v. National Gypsum Co. (E. D. Pa. 1947), 73 F. Supp. 798, 802	12
Lewis Invisible S. Mach. Co. v. Columbia B. Mach. Mfg. Co., 80 F. (2d) 862	20
Morris v. National Association of Stationers (C. A. 7th 1930), 40 F. 2d 620	21
Motley Green & Co. v. Detroit Steel & Spring Co. S.D.N.Y., 1908), 161 Fed. 389	21

PAGE

Radford v. U. S. (C. A. 5th 1959), 264 F. (2d) 709 21

SEC v. Capital Gains (1963), 375 U. S. 180 ..... 5, 6, 19, 24

Speed v. Transamerica Corp. (D. Del. 1951), 99 F. Supp. 808 ..... 5, 8, 15, 16

Strong v. Repide, 213 U. S. 419 (1908) 5

Weber v. Sec. & Exch. Comm. (C. A. 2d 1955), 222 F. (2d) 822 8

STATUTES AND RULES

Securities Exchange Act of 1934, Section 10(b), 15 U.S.C., Section 78j(b) 2

28 U.S.C., Section 1254(i) 2

Rule X—10B-5, 17 C.F.R., Sec. 240, 10(b)-5 3

MISCELLANEOUS

Vol. III, Loss, pages 1456-7 8

Restatement, Torts, Sec. 546 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that a writ of certiorari issue to review a decision of the United States Court of

Appeals for the Second Circuit, affirming a judgment granted in favor of the respondents by the Hon. Irving Ben Cooper after a trial without a jury in the Southern District of New York.

Opinions Below

Judge Cooper's opinion is reported at 227 F. Supp. 906. The case was argued in the Court of Appeals before Judges Swan, Waterman and Moore. Judge Waterman wrote the unanimous opinion of the Court which is reported at 340 F. 2d 457. A copyof the opinion also appears at page 264A of the certified record. The order and judgment of the Court of Appeals dated and entered January 4, 1965 appears at page 279A of the record.

Prior to the trial two of the defendants moved for summary judgment which motion was denied by Judge Wyatt in an opinion reported at 222 F. Supp. 798.

Jurisdiction

The suit below was based upon alleged violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) and Rule X-10B-5, promulgated by the Securities and Exchange Commission, 17 C.F.R. § 240, 10b-5.

Federal jurisdiction rests upon the alleged illegal use of the United States mail, the use of the mails being conceded by all parties.

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C., Section 1254(1).

Statute and Rule Involved

The Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. Section 78j(b) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality

of interstate commerce, or of the mails, or of any facility of any national securities exchange

* * * * * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule X-10B-5 adopted by the Securities and Exchange Commission, 17 CFR, Sec. 240, 10(b)-5, provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(1) to employ any device, scheme or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Statement of the Case

Defendants below on November 17, 1960, purchased from Albert A. List, the plaintiff, a block of 5100 shares of a corporation known as Fashion Park, Inc., at a price of

$18.50 a share, and approximately three weeks thereafter, December 7, 1960, defendants arranged to sell the stock to Hat Corporation of America at $50 a share, which sale was later completed.

In the purchase of the stock defendants failed to inform List, the seller, that defendant Lerner, the principal buyer, was a director of Fashion Park, Inc., the corporation whose stock was being sold, and defendants failed to inform the seller of certain other facts and circumstances which induced the defendants to buy, including, among other things, that Lerner, the buyer, was a director and an insider, that there was a potential buyer of the business or of the stock of the business, and that the directors of Fashion Park, Inc. adopted a resolution on November 4, 1960 in which the defendant Lerner participated, which resolution declared that Fashion Park had determined to sell to or merge with any buyer (Ex. 2B, 90a). After List discovered defendants' failure to disclose the information in their possession at the time of the sale, he began this action for damages in the sum of $160,293.00.

Prior to the trial, a motion made by defendants Green and Hentz & Co. for summary judgment was denied by Hon. Inzer B. Wyatt, D. J. (222 F. Supp. 798).

It is respectfully submitted that this decision denying motion for summary judgment is strongly in support of this petition (Judge Wyatt's opinion was completely ignored by the courts below).

I.

Certiorari should be granted in this case for the following reasons:

(a) The decision of the Court of Appeals destroys the intent of the Securities and Exchange Act of 1934 and the rules and opinions of the Securities and Exchange Commission thereunder by infusing into

the Act common law principles Congress intended to exclude.

(b) The decision of the Court of Appeals is contrary to and in conflict with the doctrine promulgated by the Supreme Court in *SEC* v. *Capital Gains* (1963), 375 U. S. 180; it also is contrary to the holding of the District Court in the Third Circuit in *Speed* v. *Transamerica Corp.* (D. Del. 1951), 99 F. Supp. 808; it also is in conflict with the principles of law applicable to the situation enunciated by the Supreme Court in *Strong* v. *Repide,* 213 U. S. 419 (1908).

(c) The decision of the Court of Appeals relieves the inside buyer of his obligation to disclose information, and is contrary to the interpretation of the Act and Rules in the *Capital Gains* case, *supra,* and in effect places on the potential seller at his peril an obligation to inquire and seek information.

II.

Questions presented for review.

Authorities and argument in support of questions for review:

ONE

The courts below refused to follow the doctrine of the *Capital Gains* case, *supra,* namely, that Congress in enacting the 1934 Act intended a broad remedial construction of the legislation which would completely cover the failure of an insider or fiduciary to disclose material facts by imposing a stricter liability than existed prior thereto.

The courts below herein seem to differentiate between the proof necessary in a disciplinary proceeding and that necessary to prove a civil action at law.

The *Capital Gains* case, *supra*, makes no such distinction. The test applied in the *Capital Gains* case is whether or not the defendant was violating the law.

TWO

To the doctrine set forth in the *Capital Gains* case, *supra*, the Court of Appeals in the case at bar has added a requirement that the victim cannot recover unless he has taken affirmative precautions to avoid the injury, such as (a) satisfying himself beforehand and without having been alerted, that the party that he is dealing with is not a director of the company; (b) making sure that the independent broker or finder attempting to make the deal has not concealed anything from him. Seller beware.

Judge Waterman stated (p. 275a):

> "That the outsider did not have in mind the negative of the fact undisclosed to him, or that he did not put his trust in the advice of the insider, would tend to prove that he would not have been influenced by the undisclosed fact even if the insider had disclosed it to him."

It is respectfully submitted that this is a confusing and contradictory statement. The first of the alternatives is:

> "That the outsider did not have in mind the negative of the fact undisclosed to him * * * (it) would tend to prove that he would not have been influenced by the undisclosed fact even if the insider had disclosed it to him."

The statement would seem to be a non-sequitur. The court therein places the burden on the outsider at his peril and without being alerted to find out all facts and entirely relieves the insider from the obligation to disclose.

The second of the above alternatives is:

> "That the outsider * * * did not put his trust in the advice of the insider, would tend to prove that he would not have been influenced by the undisclosed fact even if the insider had disclosed it to him." (p. 275a)

This alternative has no more virtue than the first.

In the case at bar there was no express representation by defendants to plaintiff. The complaint is not based upon something defendants did state. It is based entirely upon the fact that defendants completely failed to disclose information within their control and possession.

The Court of Appeals held that an essential of a cause of action under the Act is misrepresentation plus the fact that plaintiff relying upon the representation acted as a reasonable man. In the words of Judge Waterman:

> "Thus, to the requirment that the *individual plaintiff* must have acted upon the fact misrepresented, is added the parallel requirement that a *reasonable man* would also have acted upon the fact misrepresented." (272a)

And Judge Waterman states that the aim of the rule in a case such as this is not to establish "a scheme of investors insurance" (273a-274a).

But the learned judge did not explain how the same doctrine applied where there was a total failure to speak. What can the test be of the reasonableness of the non-receipt when the information is not given? Was it not the intention of the Congress that the duty placed upon the insider is an affirmative duty to disclose?

Kardon v. *National Gypsum Co.* (E. D. Pa. 1947), 83 F. Supp. 613, 614;

Speed v. *Transamerica Corp.* (D. Del 1951), 99 F. Supp. 808;
Vol. III, Loss, pages 1456-7;
Hughes & Co. v. *SEC* (C. A. 2d 1943), 139 F. (2d) 434, 436;
Weber v. *Sec. & Exch. Comm.* (C. A. 2d 1955), 222 F. (2d) 822.

Judge Waterman would seem to require that a plaintiff must prove that *if he had the information* which he did not get he would have acted differently from the way in which he acted, and that he would have been a reasonable man in so doing.

The Court of Appeals erred in adopting the Trial Court's finding (1) That List would have sold even if he had the information that one of the buyers was a director of Fashion Park, and (2) that the undisclosed resolution that Fashion Park be sold or merged was not a material fact (269a). List testified flatly and directly that he would not have sold had he known that Lerner, a director, was the purchaser (56a-57a and 59a). That he would not have sold if he had known of the adoption of the resolution of November 4, 1960. The Trial Court during the trial indicated that it was important to any shareholder to know that a director or other insider was the buyer of his stock (56a-57a).

Since the resolution of November 4, 1960, directed the Rosenbergs, the majority stockholders of Fashion Park, Inc., to merge or sell, and since it was followed soon thereafter by an offer of $50 a share by Hat Corporation, it would seem that results had proven the contention that adoption of the resolution of November 4th was indeed a material fact.

Lerner appreciated the importance of the November 4, 1960 resolution, yet he did not inform the seller that it had been adopted.

Lerner testified that he did not consider it necessary to inform the seller that he was a director of the company or of any other circumstances or conditions of the company (246a).

But Lerner also testified that he had told Chatman, the Labor Leader, that the removal of the Fashion Park employees "was literally forcing the company out of business" (208a).

As an alternative the directors, with the concurrence of the Rosenbergs, voted immediately to seek a sale or merger of the company. It was the most important happening in the life of the corporation. A sale or merger meant that the Rosenbergs were at last dislodged from the management of the corporation. Yet, the court below ruled that defendants were not obliged to disclose the adoption of that resolution to the stockholder from whom they proposed to buy a block of 5100 shares of stock, out of a total issue of approximately 60,000.

Whether the information would cause the seller to raise his estimate of the value of the stock or, on the other hand, to lower such estimate, it was solely for the seller to decide. At any rate, the seller should have been advised of the adoption of the resolution to enable him to reach his own decision as to whether or not the price that was being negotiated by the free lance broker was a fair and adequate price.

THREE

Judge Waterman points out that one of the grounds of the Trial Court's decision was "that the undisclosed possibility that Fashion Park might be sold was not a material fact" (269a).

Petitioner does not rely on the failure to disclose that Fashion Park might be sold, as elsewhere stated; defendants disclosed nothing except that Hentz & Co. (Green) had a buyer ready, able and willing to buy at $18.50 a share.

But the proposition of "materiality" runs through the opinion of the Trial Court and that of the Court of Appeals. The Court of Appeals said:

> "We affirm the decision of the trial court rejecting the claim that plaintiff was damaged through defendants' non-disclosure." (269a)

The Court assumed "there was a total non-disclosure" by defendants (270a).

Judge Waterman then proceeds to define "reliance" and "materiality" (272a).

Having already concluded that there was a complete failure on the part of the defendants herein to disclose, and that failure to disclose is a violation of the Act (272a) Judge Waterman then proceeds to measure this non-disclosure situation by principles that apply in a common law action of misrepresentation.

He quoted from *Restatement Torts*, Sec. 546, "the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss". But the case at bar does not represent a misrepresentation situation but rather a failure to disclose situation.

It is respectfully submitted that List could not have relied on facts or representations that were not revealed to him and never entered his mind.

FOUR

It is further respectfully submitted that Judge Waterman strayed from the proposition before the Court in his discussion of "reliance" and "materiality" (272a-273a).

Since it is conceded that defendants made no representations, the question before the Court should have been confined to a situation of complete silence on the part of the defendants.

Since there was no representation by the defendants there could be no false representations, except by the failure or omission to state material facts, *Strong* v. *Repide, supra.* Since there were no representations there could be no reliance thereon by plaintiff List.

The sole question was not one of falsity of representations or reliance thereon, but the sole issue was that under the provisions of the Act and the Rules of the Commission there was an affirmative duty on the part of the defendants to speak. The information that defendants had and plaintiff did not have was of the type that it would have influenced the seller's decision to sell or not to sell.

FIVE

The resolution of November 4, 1960, reasonably predicted a change in the status of the stock. Since it was generally known that the depreciated condition of the stock was due to lack of management any prospect of change of management was mighty important.

Lerner must surely have believed that the frozen status of the management was a *material fact* and clearly against the interests of the stockholders. We refer again to the minutes of the meeting of May 16, 1960 (Ex. 2A, 85a), at which meeting he and another director advocated sale or merger.

The mere fact that the resolution of November 4, 1960, was forced on the Rosenbergs would in itself indicate that it was "material" to the corporation and to all its stockholders whether or not it was beneficial.

SIX

It is respectfully submitted that the courts below were wrongly influenced by the requirements of an action for fraud and deceit in which a necessary element of proof is the affirmative misleading of the victim.

On this point Professor Loss's opinion is directly contrary to the holding of the courts below:

> "He does not have to prove 'reliance' on the misstatement or omission; he must show only that he did not know of it, which is presumably a lesser burden" (Loss, p. 1702).

In *Kardon* v. *National Gypsum Co.* (E. D. Pa. 1947), 73 F. Supp. 798, 802, the Court stated:

> "Plaintiffs' case was established when the defendants' duty and its breach was proved."

Judge Wyatt had rightly pointed out that there was no dispute that Hat Corporation had shown its interest prior to November 17th, the date of the purchase of the List stock even though Hat Corporation did not make an offer prior to that date, and even though its name had not been made known to defendants (Wyatt, J., Op. 31a).

There can be no hard and fast rule that in every situation the existence in the background of a willing buyer is of importance only if he has already made a definite offer. Under the circumstances that herein existed, the mere statement by the labor leader, Chatman, to the board of directors on November 4, 1960, of the existence of a prospective buyer or a new competing manufacturer was an influential and contributing fact to the adoption of the resolution to sell or merge. Within a matter of hours the Board had adopted the resolution to merge or sell. The minutes recite:

> "• • • it was the consensus of all that an effort should be made to sell or merge the business either with the

person Chatman had in mind or anyone else who had an interest" (89a).

Things moved swiftly thereafter. Hentz & Co. (Green) entered Sheets bidding for the stock, and Lerner increased his bid immediately. By December 1st, Hat Corporation had indicated an offer of $50 a share, and on December 7th it had released publicity that it was offering $50 a share. One step followed another. The road block to progress had been removed.

SEVEN

The Court of Appeals was in error in refusing to pass upon the issue of *implied representation*, wrongly stating that it was not presented to the Trial Court.

At page 269a, Judge Waterman stated:

> "Finally, upon appeal, he (plaintiff) now alleges for the first time that defendants impliedly misrepresented to him that the stock he sold was worth only $18.50 per share. * * * As for the allegation of misrepresentation, we decline to consider a claim not presented to the trial court which raises substantial issues of fact, requiring resolution, such as the ascertainment of the true value of plaintiff's shares on November 17, 1960."

Judge Waterman was mistaken in his assumption that the point had not been presented to the Trial Court.

At page 16 of plaintiff's Trial Brief, which was in the hands of the Trial Court, it was stated:

> "Professor Loss goes so far as to state: '* * * the insider's offer to purchase at a fixed price might be deemed to constitute an implied representation that, within reasonable limits, the stated price represents the insider's judgment of the value of the security.'" V. III, Securities Regulation, pp. 1456-7)

At page 17 of the Trial Brief the plaintiff stated:

> "The concealment in the case at bar is similar to the concealment by an over-the-counter dealer who neglects to state to a customer the market price of a stock when he is selling such customer such stock at a price above the market."

The Trial Brief also contained the following:

> "In *Hughes & Co.* v. *SEC.*, 139 F. (2d) 434, 436 (C.C.A. 2d), the Court had before it the cancellation of the Hughes charter as a dealer and broker by the Securities & Exchange Commission. The broker appealed to the Circuit Court of Appeals (2d Cir.).
>
> The Court held that a dealer in such a situation must 'be deemed to commit a fraud' by non-disclosure."

Still quoting from the Trial Brief and referring to the *Hughes* case:

> "The Court of Appeals (Clark, J. Agustus N. Hand and Chase, J.J., concurring) pointed out that although there was no finding of false statement on the part of Hughes & Co., there was a failure to disclose important information, namely, *that the price was substantially above the market.*" (Emphasis supplied)

Judge Waterman stated that the proposition raised substantial issues of fact requiring determination of the true value of plaintiff's shares on November 17, 1960 (269a).

It is respectfully submitted that there was plenty of evidence before the courts below as to the value of plaintiff's shares on November 17, 1960. Among the evidence in the record from which the Court might well have arrived at a sufficiently fair value of plaintiff's stock were the following:

Defendants bought the stock at $18.50 a share.

Defendants received $50 a share, and the offer therefor was made on December 7, 1960, two weeks after the purchase of plaintiff's stock.

The book value was conceded to be from $56 to $60 a share (61a).

The Annual Report of the corporation for 1959 was in evidence (Ex. 1).

In *Speed* v. *Transamerica,* 99 F. Supp. 808, 843, Judge Leahy stated:

> "In making an offer of 33⅓% above the current market price defendant impliedly represented that the price offered was a fair price at that time."

The *Speed* case, *supra,* was a representative action and all stockholders in the same class were entitled to recover.

Judge Waterman distinguished the *Speed* case in the following manner (273a):

> "Plaintiff also relies on the fact that in *Speed* v. *Transamerica Corp.,* 99 F. Supp. 808, 833, the court allowed a class action by the defrauded sellers, from which fact he infers that no inquiry into the reasons why each seller transferred his stock is required by Rule 10b-5. However, a comparison of that decision with the opinion in an earlier phase of the same suit, *Speed* v. *Transamerica Corp.,* 5 F.R.D., 56, 60, shows that a class action was allowed only because the court was convinced that all members of the class had relied on defendant's misrepresentation."

It is difficult to find what in the earlier report of *Speed* v. *Transamerica, supra,* convinced the Court that all members of the class had relied on defendants' misrepresentation.

We respectfully submit that the record in the *Speed* v. *Transamerica* case (a class action), indicates that the Court recognized the liability of the insider defendant to disclose even though the remaining outside stockholders had offered no evidence of defendant's non-disclosure.

Petitioner asks for no clearer statement of the law than that by Judge Leahy in the *Speed* case (99 F. Supp. 828, 829):

> "The rule is clear. It is unlawful for an insider, such as a majority stockholder to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. It is an attempt to provide some degree of equalization of bargaining position in order that the minority may exercise an informed judgment in any such transaction."

Judge Waterman was mistaken in his statement that Lerner disposed of 3137 shares out of the 4300 purchased by him at a profit of about $1 per share (p. 268a).

Judge Waterman stated that one of the facts that influenced the Trial Court was (276a):

> "* * * that within two weeks after he bought plaintiff's stock defendant Lerner disposed of part of or all of his interest in 3137 of his 4300 shares at an average profit of only $1. per share."

The record does not support the finding.

Lerner testified that on the same date on which he bought 4300 shares of List stock he caused 2000 shares thereof to be transferred to the Victoria Investment Company, Ltd.,

of which he was the largest stockholder, and whose address was in care of Leonard I. Schreiber, his attorney (212a).

Out of the remaining 2300 shares he took 1163 into his own name and later transferred those shares to the Hat Corporation at $50 a share (213a).

Lerner did not place on the record the reason why he took only 1163 shares into his own name, and 2,000 into his Canadian incorporated Victoria Investment Company.

The balance of 1137 shares is the only part that Lerner claimed to have transferred at approximately $1 per share profit. Among those to whom he transferred the 1137 shares were the following:

To Leonard I. Schreiber, who is his attorney in this law suit—100 shares (211a).

To Robert E. Springer, his local attorney in Boston—200 shares (211a, 213a).

To David B. Goldberg, another local representative associated with Springer—100 shares (211a, 213a).

To Joseph Coe, his associate in the Boston business—100 shares.

To Dr. Jordon P. Sandman, a customer of his Boston office—100 shares (213a).

To Irving Kellman, a customer of his Boston office—200 shares.

To Dr. and Mrs. Keller, customers of his Boston office—100 shares.

To Lawrence H. Nathan and his wife (Nathan being an employee of Lerner's office in Boston)—37 shares (211a).

When Lerner was asked what was his investment in Fashion Park prior to the purchase of the List stock, he said:

> "I believe the record would show that I owned approximately 3,600 shares, that my older daughter held

600 shares, that Victoria Investment Company had 2,000 shares, and that I personally owned 30,000 in face value of bonds." (248a)

He agreed that the total investment was about $100,000 or more (248a).

EIGHT

The Court of Appeals wrongfully found that List had actively solicited the sale of the stock to defendants (p. 275a). This came about through the fact that the Court of Appeals wrongfully held that Robinson in his correspondence and conversations with a number of different parties, including Fashion Park, was acting as agent or representative of List, whereas, he was at all times a free lance finder or go-between trying to bring about a meeting of minds between a prospective buyer and a prospective seller.

At all times Robinson was acting on his own as a "finder" seeking to make a deal, and never possessing any authority from List until on November 17, 1960, when he submitted to List an "offer" of $18, which was acceptable to List, if Robinson secured 50 cents additional to pay his commission. Only then did he receive authority and the sale was consummated the same day. Until then Robinson was merely a go-between, acting on his own—not as an agent of List's.

Likewise, the courts below erroneously assumed that the solicitation that resulted in the sale of the stock by List was originated by List or by Robinson on his behalf (268a). Such assumption is contrary to the record.

For years prior to November 1960 Lerner had been accumulating securities of Fashion Park, and when he became a director in May 1960, his accumulation amounted to $100,000.

During the twenty months that List was quietly sitting on his block of Fashion Park stock Lerner was soliciting Fashion Park stock through daily bids in the National Quotation Sheets referred to hereafter as Sheets. On and after November 7, 1960, H. Hentz & Co. (Green) joined Lerner as solicitors of Fashion Park stock through daily bids in Sheets.

It was those bids in Sheets that came to the attention of Robinson, the free lance broker, and it was those bids that caused Robinson to telephone Hentz & Co. (Green) for further information. In the usual and customary method of a free lance broker after Robinson telephoned Green, he then telephoned List and he repeated the procedure until he had an offer of $18 a share from Green, which he submitted to List. It was then, and only then, that List responded to Robinson's urgings to sell (275a).

The defendants were the ones who solicited stock for purchase, and their bids day after day in Sheets was bait for the outsider. In this case it was not a stockholder who found the bait and rose to surface lured by the fisherman, Green. It was Robinson, the free lance middleman who happened to know that eighteen months before he had sold a block of 5,100 shares of the stock to List. It was Robinson, on his own, acting without any authority from List and unknown to List, who contacted Green.

NINE

The Court of Appeals erred in its seeming approval of the action of the Trial Court in holding in effect that an insider owed less duty by way of disclosure to an "experienced and successful investor in securities" than to a novice (see Judge Waterman's Opinion, p. 275a).

This Court in the case of *SEC* v. *Capital Gains, supra,* did not stipulate that there should be exceptions to the rule that compels disclosure.

Professor Loss points out that the credulity or knowledge and experience of the victim is of no importance:

> "* * * omissions to state material facts are not justified by the investor's sophistication or independent knowledge. Leonard Burton Corp., Sec. Ex. Act, Rel. 5978 (1959) 5. This seems like another way of saying that reliance is not an element of the offense under the SEC provision as it is in common-law deceit" (Loss, pp. 1438, 1439).

TEN

The Court of Appeals completely ignored the fact that there was an unknown buyer lurking in the background. Chatman, the labor leader, had revealed this fact to the Rosenbergs in October, and on November 4th, 1960, at the board of directors meeting of Fashion Park he stated that he had a manufacturer whom he proposed to bring into Rochester, or who would be interested in purchasing the stock of Fashion Park, whose name he would not disclose until he had a commitment by the board of directors that the majority stockholders would sell. He disclosed the name of this proposed purchaser to Rosenberg, Jr., on November 14, 1960, ten days after the resolution had been adopted. The manufacturer was Hat Corporation of America (Ex. 2B, p. 88a).

ELEVEN

Conspiracy was not an essential element of plaintiff's case.

In *Lewis Invisible S. Mach. Co.* v. *Columbia B. Mach. Mfg. Co.*, 80 F. (2d) 862, Judge Learned Hand, at page 864, clearly stated the law involved:

> "So far as the counterclaim pleads conspiracy at common law it was not a cause of suit independent of the tortious conduct involved in its execution. Whatever

may be the rule in criminal conspiracies, it is well settled that the civil liability does not depend upon the confederation (which need be alleged only by way of inducement), but upon the acts committed in realization of the common purpose."

See also:

Motley Green & Co. v. *Detroit Steel & Spring Co.* (S.D.N.Y., 1908), 161 Fed. 389;
Morris v. *National Association of Stationers* (C. A. 7th 1930), 40 F. 2d 620.

The charge of conspiracy in the case at bar is not the basis of the action, but the violation of the Federal Statute and Rule X10B-5, is the basis of the action.

Radford v. *U. S.* (C. A. 5th 1959), 264 F. (2d) 709;
Morris v. *National Association of Stationers, supra.*

Whether or not proof of conspiracy was essential, petitioner does not admit that proof is lacking. The records show that defendants acted in unison in purchasing and dividing up plaintiff's stock.

Defendants at the time were violating the terms of the Act in question, their mutual efforts to violate the law were clearly a conspiracy.

TWELVE

The Court of Appeals completely disregarded many undisputed facts to reach a conclusion that plaintiff was not entitled to judgment against the defendant Lerner and Green for the amount demanded in plaintiff's complaint together with interest from November 17, 1960.

Judge Waterman for the Court of Appeals said:

> "Neither plaintiff nor his broker knew that H. Hentz & Co. were brokers for a Fashion Park director who was one of the purchasers of the stock, or that the company's management was considering the sale of the company." (p. 268a)

This finding by the Court of Appeals coupled with the other undisputed facts makes the defendants Lerner, Green and H. Hentz & Co. liable for their failure to disclose any material facts to their knowledge and not within the knowledge of the plaintiff List.

It is undisputed that on November 7, 1960 defendant Lerner raised his offer in the Sheets, and H. Hentz & Co. on the same day through defendant Green went into the Sheets for the first time.

November 7th (a Monday) was the next business day after the meeting of Friday, November 4, 1960 when the resolution was unanimously passed by the directors of Fashion Park ordering the management to sell or merge the company.

The undisputed evidence is that Lerner was elected a director of Fashion Park on May 12, 1960 and attended his first meeting of directors of Fashion Park four days later, to wit, May 16, 1960 (Ex. 2A, p. 83a). At this meeting he and another director urged management of Fashion Park to sell or merge the company but Lerner did not accomplish his purpose until the resolution was passed on November 4, 1960 and the roadblock was removed so that the company could secure new management to replace the inefficient management of the Rosenbergs (Ex. 2B, p. 87a).

It is undisputed that List purchased his shares from Kidder, Peabody & Co. in January 1959. Shortly after his purchase, he asked Robinson, the free lancer who brought the opportunity to him, if it were possible, to buy

control of Fashion Park as it was evident that Fashion Park's troubles were due entirely to management. On being informed that the Rosenbergs would not sell, List did nothing about his stock until Robinson called to his attention Exhibit 5 (p. 95a) when Rosenberg wrote Seligson on October 31, 1960 that the company was not for sale.

List had no knowledge, as Judge Waterman pointed out, that the company's management was considering the sale of the company; yet, on November 4, 1960 the resolution to sell or merge the company was passed by Lerner and his fellow directors.

List then sat with his stock until November 17, 1960 when Robinson advised him he had an offer of $18.50 per share for the 5100 shares. Then and only then (p. 58a) did he authorize Robinson to sell the shares; and again referring to Judge Waterman's finding List had no knowledge that 4300 shares were being purchased by H. Hentz & Co. for Lerner, the director, and 800 shares for Green and his family.

It is undisputed that Lerner and William P. Green were co-workers on this deal; that they were both specialists in discount situations; that Green and Lerner had been conferring for many months before November 4, 1960 in regard to Fashion Park and were in daily contact with each other, not only on the Fashion Park situation but on many other transactions (68a, 74a).

Green, even after Hat Corporation had made the offer of $50 a share for Fashion Park's stock, purchased 200 shares from customers of H. Hentz & Co. without disclosing that Hat Corporation were actually committed to a $50 price (80a).

Green testified (74a) that Lerner and he talked almost every day; that it was normal business to be in constant touch with each other. (See also 60a, 68a and 69a.)

In fact, Green testified he discussed Fashion Park with Mr. Lerner a year before he actually bought any stock (61a).

Lerner recognized the necessity of advising any outside purchaser of Fashion Park stock from Lerner, that he must give notice to the outsider that Lerner was a director of Fashion Park, Inc. (defendant Lerner's Ex. H, 102a). A rubber stamp appears on each confirmation sheet that he issued to alleged purchasers of a part of the List stock which reads as follows:

> "Mr. Louis C. Lerner of our firm is a director of the above corporation."

This stamp specifically refers to List's Fashion Park stock. Lerner testified that he placed this stamp or caused it to be placed on the sale of every share of stock of any company in which he was a director (81a).

He further testified on the same page that he put the stamp on these exhibits on advice of counsel but he did not seek advice of counsel at the time he was purchasing List's stock or a part thereof. Lerner did not testify that he put the stamp on similar exhibits when he purchased stock from outside stockholders in corporations in which he was an insider.

Coupling these admitted facts with the opinion of the Court of Appeals, it is respectfully urged that the courts below were in error in finding against the plaintiff.

Conclusion

It is respectfully submitted that the decision of the Court of Appeals failed in its entirety to follow the principle set down by this Court in the *Capital Gains* case, *supra,* and imposes upon all non-alerted outside stockholders an obligation [in order to protect themselves against machinations of insiders] without having been

alerted, to make a thorough search to discover whether or not the insider is deliberately utilizing to his own advantage facts and information not known to the outsider.

If the mandate embodied in the Statute, the SEC Rule and the decisions of this Court are to retain vitality, this Court's attention is urgently needed on this application.

A Writ of Certiorari should accordingly be granted.

Respectfully submitted,

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
Attorneys for Petitioner.

Of Counsel:

O'BRIEN, DRISCOLL & RAFTERY,
152 West 42nd Street,
New York, N. Y. 36.

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
MAR 30 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

No. [redacted]

OCTOBER TERM, 1964

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
Attorneys for Petitioner.

Of Counsel:

O'BRIEN, DRISCOLL & RAFTERY,
152 West 42nd Street,
New York, N. Y. 36.

TABLE OF CONTENTS

	PAGE
Opinion	1
Judgment	15

Opinion.

(340 F. 2d 457 (1965))

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 76—September Term, 1964.

(Argued November 9, 1964 Decided January 4, 1965.)

Docket No. 28986

ALBERT A. LIST,

Plaintiff-Appellant,

—v.—

FASHION PARK, INC., *et al.*,

Defendants,

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc., JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually, and BERNARD A. GREEN, individually and doing business under the firm name and style of Beaver Associates,

Defendants-Appellees.

Opinion.

Before:

SWAN, WATERMAN and MOORE,

Circuit Judges.

Appeal from judgment of the United States District Court for the Southern District of New York, Cooper, *J.*, reported at 227 F. Supp. 906, dismissing suit brought pursuant to 15 U. S. C. § 78j(b) and 17 C. F. R. § 240.10b-5. Affirmed.

O'BRIEN, DRISCOLL & RAFTERY (Arthur F. Driscoll, Edward C. Raftery, Milton M. Rosenblum, of counsel), New York City, *for Plaintiff-Appellant.*

LEONARD I. SCHREIBER, New York City, *for Defendant-Appellee Louis C. Lerner.*

BAER, MARKS, FRIEDMAN & BERLINER (William E. Friedman, of counsel), New York City, *for Defendants-Appellees H. Hentz & Co. and William P. Green.*

WATERMAN, *Circuit Judge*:

Plaintiff brought suit in the United States District Court for the Southern District of New York, seeking damages of $160,293 from numerous individual, partnership, and corporate defendants. The suit was based upon alleged violations of Section 10(b) of the Securities Exchange Act, 15 U. S. C. § 78j(b),[1] and Rule 10b-5, promulgated there-

---

[1] It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any secruity not so registered, any manipulative or deceptive

under by the Securities and Exchange Commission, 17 C. F. R. § 240.10b-5.[2] Two of the defendants moved for summary judgment, but the motion was denied by Judge Wyatt in an opinion reported at 222 F. Supp. 798. The case was subsequently tried before Judge Cooper sitting without a jury. At the close of plaintiff's evidence, plaintiff took a voluntary non-suit as to some of the defendants, including Fashion Park, Inc. When the entire trial was completed, Judge Cooper, in an opinion reported at 227 F. Supp. 906, dismissed the complaint as against the remaining defendants.

The crucial facts of the case are for the most part undisputed. Fashion Park is a manufacturer and distributor of men's clothing with headquarters in Rochester, New York. The company had not been prospering for several years preceding the events of this suit, and its factory employees were working only part-time. In September and October, 1960, the manager of the union which represented Fashion Park's employees warned the president and the chairman of the board, Fashion Park's majority shareholders, that he would take a substantial number of employees away from Fashion Park if he could induce an-

---

device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[2] It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

other clothing manufacturer to settle in Rochester. In response to this threat, the president of Fashion Park called a directors' meeting for November 4, 1960. Among the directors who attended was defendant Lerner, a minority shareholder.

At the meeting the union manager reiterated his plan to withdraw 300 to 350 employees, and urged the board to consider selling Fashion Park. He told the board that he knew of someone who might be interested in buying the company, but he neither disclosed the name of his prospective purchaser nor any potential purchase terms. The directors then adopted a resolution to the effect that the company seek to negotiate a sale or a merger. Ten days later, the union manager revealed to the president of Fashion Park that the prospective purchaser was Hat Corporation of America, but this information was not relayed to defendant Lerner until the following month. Negotiations between Fashion Park and Hat Corporation began on November 22, 1960, a preliminary understanding was announced on December 7, 1960, and the formal contract of sale was signed on February 3, 1961. By one of the contractual provisions, Hat Corporation agreed to offer $50 per share to all minority shareholders of Fashion Park.

Plaintiff, an experienced and successful investor, had purchased 5100 shares of Fashion Park stock in January, 1959 at $13.50 per share. About November 11, 1960, with the advice of his broker, he authorized the sale of his stock at a net price to him of not less than $18 per share. At that time, defendants Lerner and H. Hentz & Co., as well as another director of Fashion Park, were bidding for Fashion Park stock through the National Quotation Bureau sheets. Plaintiff's broker knew that two directors were bidding for the company's stock, but he did not think it important to disclose this fact to plaintiff, and plaintiff had not sought to learn whether Fashion Park directors were bidding for the stock.

Opinion.

On November 16, 1960, plaintiff's broker called H. Hentz & Co. to invite a purchase of plaintiff's stock at $20 per share. Defendant William P. Green, the partner in H. Hentz & Co. who handled the transaction, contacted Lerner and Beaver Associates to ask if they would like to participate in the purchase. (Green and his brother, defendant Bernard A. Green, are partners in Beaver Associates.) After intensive negotiations between plaintiff's broker and William P. Green, and among Green, Lerner, and Beaver Associates, the sale of the 5100 shares was consummated on November 17, 1960 at $18.50 per share. 4300 shares went to Lerner, 400 to William P. Green and his daughter, and 400 to Beaver Associates. Within two weeks after the transaction, Lerner disposed of part or all of his interest in 3137 of the shares, at an average profit of about $1 per share. At the time of the transaction, William P. Green knew that Lerner was a director of Fashion Park; he may not have known of the resolution of November 4, 1960 to sell or merge the company. Neither plaintiff nor his broker knew that H. Hentz & Co. were brokers for a Fashion Park director who was one of the purchasers of the stock, or that the company's management was considering the sale of the company.

Plaintiff brought suit on February 24, 1961, claiming the difference between the price ($18.50) at which he sold his 5100 shares of Fashion Park stock and the price ($50) which Hat Corporation subsequently offered to Fashion Park's minority shareholders. He alleged that defendants had conspired to buy his stock and then to sell it at a substantial profit, and that they had failed to disclose to him material facts in their possession which would have affected his decision to sell his stock. Insofar as is pertinent to this appeal, the undisclosed facts, alleged to be material, upon which plaintiff relied to support his allegations, were that one of the buyers of his stock was a director of Fash-

ion Park, and that the Fashion Park board, with a potential purchaser on the horizon, had resolved to sell or merge the company. In the opinion dismissing the complaint, the trial court held that there was insufficient evidence of a conspiracy, that plaintiff would have sold even if he had known that one of the buyers was a director of Fashion Park and that the undisclosed possibility that Fashion Park might be sold was not a material fact.

Plaintiff appeals from the decision of the trial court rejecting his claim that he was damaged by defendants' non-disclosures. He also appeals from the dismissal of his claim that there was a conspiracy among defendants, but he apparently relies upon this ground only if we choose to reverse the other adverse holdings of the trial court. Finally, upon appeal, he now alleges for the first time that defendants impliedly misrepresented to him that the stock he sold was worth only $18.50 per share. We affirm the decision of the trial court rejecting the claim that plaintiff was damaged through defendants' non-disclosures. Therefore we need not independently review the dismissal of the claim that there was a conspiracy to damage him. As for the allegation of misrepresentation, we decline to consider a claim not presented to the trial court which raises substantial issues of fact, requiring resolution, such as the ascertainment of the true value of plaintiff's shares on November 17, 1960.

The general principles governing suits such as this were definitively set forth in the often cited case of *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 828-29 (D. Del. 1951), *aff'd*, 235 F. 2d 369 (3 Cir. 1956):

> It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder

> by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. It is an attempt to provide some degree of equalization of bargaining position in order that the minority may exercise an informed judgment in any such transaction.

Moreover, "a broker who purchases on behalf of an insider and who has knowledge of inside information would seem to be under the same obligation to disclose as the insider who purchases directly." III Loss, Securities Regulation 1452 (2 ed. 1961).

At the outset, defendant Lerner contends that the courts have never applied Rule 10b-5 in a civil suit involving total non-disclosure. By "total non-disclosure" defendant presumably means that there was no significant communication bearing upon value by buyer to seller except for offer, counteroffer, acceptance, or rejection. The trial judge made no findings relative to this contention, but we are prepared to assume with defendant that, in the sense defendant uses the term, there was a total non-disclosure by defendants to plaintiff.

Although there may be no square holdings in civil suits under Rule 10b-5 involving total non-disclosure, there are ample dicta to the effect that "lack of communication between defendant and plaintiff does not eliminate the possibility that Rule 10b-5 has been violated." *Cochran* v. *Channing Corp.*, 211 F. Supp. 239, 243 (S. D. N. Y. 1962); see *Speed* v. *Transamerica Corp., supra* at 829. Apparently there are no dicta to the contrary in any of the cases. Furthermore, in the leading case of *Strong* v. *Repide,* 213 U. S. 419 (1909), the Supreme Court found common law

fraud by an insider in the purchase of stock from a minority shareholder, even though "perfect silence was kept" by the defendant. Surely we would suppose that Rule 10b-5 is as stringent in this respect as the federal common law rule which preceded it. III Loss, Securities Regulation 1448-49 n. 10.

The doctrine for which defendant Lerner contends would tend to reinstate the common law requirement of affirmative misrepresentation. Such a tendency contravenes the purpose of Rule 10b-5 in cases like this, as enunciated in *Speed* v. *Transamerica Corp., supra,* which precludes not only the conveyance of half truths by the buyer which actually mislead the seller, but, as well, failure by the buyer to disclose the full truth so as to put the seller in an equal bargaining position with the buyer. Moreover, the effect of adopting such a doctrine would be automatically to exempt many impersonal transactions. This effect would be contrary to the intent of Congress, as set forth in Section 2 of the Securities Exchange Act, 15 U. S. C. § 78b, which was to regulate "transactions in securities as commonly conducted upon securities exchanges [as well as] over-the-counter markets." But see III Loss, Securities Regulation 1455-56.

It may well be that suits under Rule 10b-5 involving total non-disclosure cannot be brought pursuant to clause (2) of the rule. III Loss, Securities Regulation 1439. *Contra, Speed* v. *Transamerica Corp., supra.* Perhaps, as defendant Lerner contends, they cannot be brought pursuant to clause (1) either. *Joseph* v. *Farnsworth Radio & Television Corp.,* 99 F. Supp. 701, 706 (S.D.N.Y. 1951), *aff'd* 198 F. 2d 883 (2 Cir. 1952). *Contra,* III Loss, Securities Regulation 1439. But we fail to see that it makes any difference which clause of Rule 10b-5 is relied on by plaintiff, and no reason for requiring a choice here has been pointed out to us.

Because there is much disagreement and confusion among the parties concerning the meaning and applicability of "reliance" and "materiality" under Rule 10b-5, we think it advisable first to set forth the well known and well understood common law definitions of these terms and the reasons for the rules in which the terms are incorporated. Insofar as is pertinent here, the test of "reliance" is whether "the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss." Restatement, Torts § 546 (1938); *accord,* Prosser, Torts 550 (2 ed. 1955); I Harper & James, Torts 583-84 (1956). The reason for this requirement, as explained by the authorities cited, is to certify that the conduct of the defendant actually caused the plaintiff's injury. The basic test of "materiality," on the other hand, is whether "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question." Restatement, Torts § 538(2)(a); *accord,* Prosser, Torts 554-55; I Harper & James, Torts 565-66. Thus, to the requirement that the *individual plaintiff* must have acted upon the fact misrepresented, is added the parallel requirement that a *reasonable man* would also have acted upon the fact misrepresented.[3]

The parties to this suit apparently agree that the requirement that a misrepresentation be material is carried over into civil cases under Rule 10b-5 involving nondisclosure by an insider. Moreover, the meaning of the

---

[3] Care must be taken to distinguish the requirement that a reasonable man would have *believed* the fact misrepresented. There is a marked present-day trend away from this common law requirement. Prosser, Torts 552-54; I Harper & James, Torts 582-83. The requirement may not exist at all under Rule 10b-5. See III Loss, Securities Regulation 1438.

term is ostensibly the same as at common law. III Loss, Securities Regulation 1431. "Materiality" encompasses those facts "which in reasonable and objective contemplation might affect the value of the corporation's stock or securities . . ." *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 642 (7 Cir. 1963).

Disagreement centers on the applicability and meaning of the requirement that reliance be placed upon the misrepresentation. Our examination of the authorities satisfies us that this requirement also is carried over into civil suits under Rule 10b-5. *Reed* v. *Riddle Airlines*, 266 F. 2d 314, 319 (5 Cir. 1959); *Kohler* v. *Kohler Co.*, 208 F. Supp. 808, 823 (E. D. Wis. 1962), *aff'd*, 319 F. 2d 634 (7 Cir. 1963); *Mills* v. *Sarjem Corp.*, 133 F. Supp. 753, 767 (D. N. J. 1955); *Speed* v. *Transamerica Corp.*, 5 F. R. D. 56, 60 (D. Del. 1945); *accord*, Loss, Securities Regulation 1765-66. The dicta in *Kardon* v. *National Gypsum Co.*, 83 F. Supp. 613, 614 (E. D. Pa. 1947), are not necessarily to the contrary. Plaintiff also relies on the fact that in *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 833, the court allowed a class action by the defrauded sellers, from which fact he infers that no inquiry into the reasons why each seller transferred his stock is required by Rule 10b-5. However, a comparison of that decision with the opinion in an earlier phase of the same suit, *Speed* v. *Transamerica Corp.*, 5 F. R. D. 56, 60, shows that a class action was allowed only because the court was convinced that all members of the class had relied on defendant's misrepresentation.

This interpretation of Rule 10b-5 is a reasonable one, for the aim of the rule in cases such as this is to qualify, as between insiders and outsiders, the doctrine of *caveat emptor*—not to establish a scheme of investors' insurance. Assuredly, to abandon the requirement of reliance would

be to facilitate outsiders' proof of insiders' fraud, and to that extent the interpretation for which plaintiff contends might advance the purposes of Rule 10b-5. But this strikes us as an inadequate reason for reading out of the rule so basic an element of tort law as the principle of causation in fact. Plaintiff's citation of decisions by the Securities and Exchange Commission, and commentary thereon, does not persuade us otherwise. *Cady, Roberts & Co.*, Sec. Ex. Act Rel. 6668, p. 9 (1961); III Loss, Securities Regulation 1438-39 n. 30. The aim of administrative proceedings under Rule 10b-5 is to deter misconduct by insiders, rather than to compensate their victims. That, because of the peculiar circumstances of the particular outsiders involved, no harm actually results from the misconduct is ordinarily irrelevant to this preventive purpose. But see III Loss, Securities Regulation 1764.

On the other hand, we do not agree with certain overtones in the opinion of the trial court concerning the meaning of "reliance" in a case of non-disclosure under Rule 10b-5. The opinion intimates that the plaintiff must prove he actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. Such a requirement, however, would unduly dilute the obligation of insiders to inform outsiders of all material facts, regardless of the sophistication or naivete of the persons with whom they are dealing. *Connelly* v. *Balkwill*, 174 F. Supp. 49, 59 (N. D. Ohio 1959), *aff'd*, 279 F. 2d 685 (6 Cir. 1960), must be read in light of the fact that the prime defendant in that case was not an insider.

The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact. *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 829; *Kardon* v. *National*

Gypsum Co., 73 F. Supp. 798, 800 (E. D. Pa. 1947). To put the matter conversely, insiders "are not required to search out details that presumably would not influence the person's judgment with whom they are dealing." *Kohler* v. *Kohler Co., supra,* 319 F. 2d at 642. This test preserves the common law parallel between "reliance" and "materiality," differing as it does from the definition of "materiality," under Rule 10b-5 solely by substituting the individual plaintiff for the reasonable man. Of course this test is not utterly dissimilar from the one hinted at by the trial court. That the outsider did not have in mind the negative of the fact undisclosed to him, or that he did not put his trust in the advice of the insider, would tend to prove that he would not have been influenced by the undisclosed fact even if the insider had disclosed it to him.

The trial court concluded that plaintiff would have sold his stock even if he had known that defendant Lerner, an insider, was one of the buyers. The trial court based this result upon its findings that plaintiff is an experienced and successful investor in securities; that he actively solicited the sale to defendants; that he did not ask his broker whether any insiders were bidding for stock in the corporation; that his broker knew two directors were bidding but did not think it necessary to inform plaintiff of this; that the only restriction plaintiff placed on his broker related to price; and that his broker suggested that five points would be a nice profit, to which plaintiff agreed. From these facts, the trial court presumably inferred that plaintiff was so desirous of "the potential five point profit he would make" and so reliant on knowledge acquired through "his many dealings in the securities field" that the identity of the buyer would have been of little or no concern to him.

We cannot say that the finding of the trial court was

clearly erroneous.[4] Cf. *Kohler* v. *Kohler Co., supra,* at 642, in which the court held:

> "Here, the company could fairly deal with a person who had had many years of intimate acquaintance with the affairs of the corporation, who was closely related to many principals of the corporation, who had extrinsic sources of sound business advice, and who himself was promoting a speedy sale, in a manner that might not be fair if plaintiff had been a novice to stock transactions or the corporation's activities."

The trial court also concluded that adoption of the November 4, 1960 resolution, and the setting in which it occurred, were not material facts that should have been disclosed to plaintiff. This result was based in part on the undisputed facts that at the time the resolution was adopted the Fashion Park directors only had before them the statement of the union manager that he knew of some unidentified person who would be interested in buying Fashion Park; that by the time plaintiff sold his stock on November 17, 1960 nothing more had occurred except that the president of Fashion Park had learned the name of the potential purchaser; and that within two weeks after he bought plaintiff's stock defendant Lerner disposed of part or all of his interest in 3137 of his 4300 shares at an average profit of only about $1 per share. The trial court presumably inferred from these facts that the prospects for "a

---

[4] In view of this result, we express no opinion on the totally novel question of whether failure by an insider to disclose his identity can ever be a violation of Rule 10b-5. See generally III Loss, Securities Regulation 1463-65. We also find it unnecessary to decide whether, as defendants H. Hentz & Co. and William P. Green contend, knowledge of the fact that two directors were bidding for Fashion Park stock, known to plaintiff's broker, can be imputed to plaintiff so as to bar plaintiff from recovery.

sale of Fashion Park" and for a sale at a price "profitable to shareholders," insofar as Lerner and the other defendants apprehended them to be at the time they purchased plaintiff's stock, were too remote to have influenced the conduct of a reasonable investor.

Here too, the finding of the trial court was not clearly erroneous.[5] Cf. *James Blackstone Memorial Library Ass'n* v. *Gulf, Mobile & Ohio R.R. Co.*, 264 F. 2d 445, 450 (7 Cir. 1959), *cert. denied*, 361 U. S. 815 (1959), in which the court said:

> "[W]e are aware of no case which [furnishes support] for plaintiffs' contention that Gulf under the facts and circumstances of this case was under obligation to inform plaintiffs of its desire to sell the Harrison Street property or that it hoped to sell such property to the government."

Compare *Strong* v. *Repide, supra; Speed* v. *Transamerica Corp., supra; Kardon* v. *National Gypsum Co., supra.*

Affirmed.

---

[5] In view of this result, we express no opinion on the unsettled question of whether, as defendants H. Hentz & Co. and William P. Green argue, they cannot be held liable because they were found by the trial court to have had no actual knowledge of the November 4, 1960 resolution and the surrounding circumstances. See generally III Loss, Securities Regulation 1465-66.

Judgment.

UNITED STATES COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fourth day of January one thousand nine hundred and sixty-five.

Present: HON. THOMAS W. SWAN,
HON. STERRY R. WATERMAN,
HON. LEONARD P. MOORE,
Circuit Judges.

ALBERT A. LIST,

Plaintiff-Appellant,

v.

FASHION PARK, INC., et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District

Court be and it hereby is affirmed with costs to the appellees other than Bernard A. Green.

A. DANIEL FUSARO,
Clerk.

A true copy,

A. DANIEL FUSARO,
Clerk.

VINCENT A. CARLIN,
Chief Deputy Clerk.

66
LIBRARY
SUPREME COURT, U. S.

No. [redacted]

Office-Supreme Court, U.S.
FILED
APR 19 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

RESPONDENT LERNER'S BRIEF IN OPPOSITION

LEONARD I. SCHREIBER,
Attorney for Respondent,
Lerner,
Office and P. O. Address,
22 East 40th Street,
New York 16, New York.

TABLE OF CONTENTS

	PAGE
Comment on Petitioner's Statement of the Case	1
The Opinions Below	2
Facts	4
Detailed Chronology of Events Preceding the November 17, 1960 Transaction	6
Plaintiff's Hindsight	9
The Surrounding Circumstances	12
The Buyer's Identity	14
Reasons for Denying the Writ	14
Conclusion	15

CASES CITED:

American Tobacco Co. v. The Katingo Hadjipatera, 194 F. 2d 449, 451 (2d Cir. 1951)	3
Grindroff v. Prince, 189 F. 2d 897 (2d Cir. 1951)	3
Kohler v. Kohler Co., CCH Fed. Sec. L. Rep. pars. 91,243, page 94118 (7th Cir. 1963)	13
SEC v. Capital Gains, 375 U. S. 180 (1963)	14
Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1961)	14
Strong v. Repride, 213 U. S. 419 (1908)	14
The Implications of Cady Roberts, 17 Bus. Law 939, 958 (1962)	13
United States v. U. S. Gypsum Co., 333 U. S. 364, 394-5 (1948); rehearing den. 333 U. S. 869	3
United States v. Jones Beach Auth., 255 F. 2d 329 (2d Cir. 1958)	3
United States v. Yellow Cab Co., 338 U. S. 338 (1949)	3

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

RESPONDENT LERNER'S BRIEF IN OPPOSITION

Comment on Petitioner's Statement of the Case

Before attempting, by restatement in depth, to correct (by record reference) petitioner's wishful version of the facts, reference is respectfully directed to the opinion of

the District Judge (6a *et seq.*) which constitutes the findings of fact herein, and to the opinion of the Court of Appeals (279a) which affirmed such findings.

The Opinions Below

The opinion of the District Judge (6a), which constitutes the findings of fact and conclusions of law required by F. R. Civ. P. 52 (23a), after setting forth the claimed material facts alleged to have been withheld by defendants* and upon the basis of which plaintiff claims the right to recover (14a), held:

> "If plaintiff can establish the alleged facts, show they were unknown to him when he made his sale, and prove that had they been made known to him they would have affected his sale, he must recover." (15a)

The Court below then proceeded to analyze the facts adduced at the trial and concluded:

> "Plaintiff has failed to show the existence of a material fact which, if known to him, would have affected his sale.
>
> "Accordingly, plaintiff has failed to establish by a fair preponderance of the credible evidence either that defendants contravened the Securities and Exchange Act of 1934 or Rule X-10b-5, or that defendants conspired in any way to defraud him.
>
> "In sum, the total evidence adduced upon the trial fails to meet either quantitatively or qualitatively the imperative burden of proof which rests upon plaintiff as to the material allegations set out in this complaint. The complaint is dismissed against the defendants with costs.
>
> "This opinion constitutes findings of fact and conclusions of law as required by F. R. Civ. P. 52." (23a)

---

* Here, the respondents.

F. R. Civ. P. 52(a) provides that findings of fact in actions tried without a jury "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

As held in *United States* v. *Jones Beach Auth.*, 255 F. 2d 329 (2d Cir. 1958):

> "The appellate court cannot substitute its judgment for that of the trial court in the absence of clear error."

Accord:

> *United States* v. *U. S. Gypsum Co.*, 333 U. S. 364, 394-5 (1948); rehearing den. 333 U. S. 869;
> *United States* v. *Yellow Cab Co.*, 338 U. S. 338 (1949);
> *Grindroff* v. *Prince*, 189 F. 2d 897 (2d Cir. 1951).

As held in *American Tobacco Co.* v. *The Katingo Hadjipatera*, 194 F. 2d 449, 451 (2d Cir. 1951):

> "We accept, as we must, those of the trial judge's inferences of fact which he drew directly from his estimates of the credibility of witnesses whom he observed as they testified in his presence. . . ."

The unanimous opinion of the Court of Appeals (279A), reviewing plaintiff's two-pronged factual contentions, on appeal held:

> "We cannot say that the finding of the trial court was clearly erroneous . . .
>
> . . . . . .
>
> "Here too, the finding of the trial court was not clearly erroneous."

Facts

The record, upon which were based the opinions below, discloses the following:

On November 17, 1960, plaintiff sold 5,100 shares of Fashion Park to Hentz & Co., as broker (hereinafter "Hentz"), for $18.50 a share (106a—Adm. of Facts 5/31/62, ¶ 17). Hentz, as broker, purchased 400 of these shares for defendant William P. Green and his daughter, 400 for Beaver Associates and 4300 for Lerner (152a-153a—Adm. of Facts 5/31/62, ¶ 20). The shares had been purchased by plaintiff January 29, 1959 for $13.50 a share. Plaintiff's profit was $25,500 (List 183a; Robinson 153a, 161a, 163a; 259a—Hentz Exh. A).

The sale originated November 16, 1960, when plaintiff's broker, Textile Shares Corporation telephoned Hentz, stated he had seen Hentz in the "sheets", and asked if Hentz would buy a block of about 5,000 shares of Fashion Park at $20 (105a—Adm. of Facts 5/31/62, ¶ 12; Robinson 158a-159a; Green 226a).

Hentz replied that it had an order to buy only 400 shares but agreed to try and place the block offered (226a-227a). Said 400-share order was from Beaver Associates (Green 225a-229a). Hentz telephoned Lerner, who said he would not pay more than $17.50 and that he had refused a large block offered at over $19 a share (105a—Adm. of Facts 5/31/62, ¶ 13; Green 227a; Lerner 209a-210a).

The next day and several telephone calls later, a price of $18.50 was agreed upon, and the shares sold (106a—Adm. of Facts 5/31/62, ¶ 17; Green 227a-228a; Robinson 161a). Hentz knew Lerner was a director of Fashion Park (105a—Adm. of Facts 5/31/62, ¶ 14; Green 203a, 238a; Lerner 245a-246a). So, too, did plaintiff and his broker (105a—Adm. of Facts 5/31/62, ¶ 15; List 187a, 198a).

Of the 4,300 shares purchased by Lerner, Lerner—himself a broker—retained 1,163 shares for his own investment account, and promptly resold the remaining 3,137 shares at a small profit ranging from 17¢ to $1.50 a share (106a—Adm. of Facts 5/31/62, ¶ 21; 102a—Lerner Exh. H; Lerner 221a-224a).

In accordance with usual brokerage practice (106a—Adm. of Facts 5/31/62, ¶ 19; Robinson 162a) at the time of the sale, Hentz did not know the name of the seller and Textile Shares Corp. did not know the name of the buyer (106a—Adm. of Facts 5/31/62, ¶ 18; Robinson 49a; Green 238a, 241a). Nor did plaintiff inquire as to the identity of the buyer (108a—Pre-trial order 1/11/63, ¶ 3 (a) 2; List 199a).

Lerner's association with Fashion Park, in brief, had been as follows: On March 23, 1955, Lerner first became a stockholder (Lerner 204a). On May 12, 1960, at the annual stockholders' meeting, Lerner was elected a director (Rosenberg, Jr. 110a-111a). At that time, he and his family owned about 4,200 shares (Lerner 247a-248a). Since 1955, he had been in the sheets bidding for Fashion Park stock (Lerner 62a, 81a-82a). Between October 14, 1960 and November 4, 1960, Lerner's bid price ranged between 15½ and 16 (100a—Pl. Exh. 8). From November 7 through November 14, 1960, Lerner's bid was $16 and his asking price was $18 (*id.*). Lerner's bid was increased on November 15 to $17, and on November 17 to $18 (*id.*).

For at least 6 months prior to the telephone call from Hentz on November 16, 1960, Lerner had had no dealings with Hentz concerning Fashion Park (Lerner 206a) and Lerner had refused offers from two other dealers who had offered a large block at a price in excess of $19 (Lerner 210a; Green 227a).

Detailed Chronology of Events Preceding the November 17, 1960 Transaction

Early in September, 1960, Abraham Chatman, manager of the Rochester Joint Board, Amalgamated Clothing Workers of America, conferred privately with defendant Rosenberg, Sr. Chatman stated that he wished to take away a substantial number of employees from Fashion Park since there wasn't enough full-time work available, and that he was trying to interest another manufacturer to open in Rochester and use these Fashion Park employees (Chatman 147a; Rosenberg, Jr. 114a-115a). Chatman repeated this to defendant Rosenberg, Jr. on October 4, 1960 (Chatman 147a; Rosenberg, Jr. 114a).

About October 24, 1960, Seligson, an attorney, phoned Rosenberg, Jr. and asked if the Rosenbergs would sell their stock (Seligson 220a-221a; 96a—Pl. Exh. 6). This was done at the request of plaintiff's broker (Seligson 221a), without plaintiff's knowledge (List 187a, 196a, 197a-198a). Rosenberg replied "no". Seligson nevertheless repeated his inquiry by letter (96a—Pl. Exh. 6).

On October 31, 1960, Rosenberg, Jr. wrote Seligson that the Rosenbergs were not interested in selling their stock in Fashion Park or its business, and did not want Seligson to make any efforts in that direction (95a—Pl. Exh. 5). Upon receipt of this information—with which plaintiff does not even claim Lerner was in any way connected—plaintiff claims to have directed his broker (Robinson) to sell his stock (List 195a; Robinson 153a-154a, 168a). Plaintiff had long known that a majority of Fashion Park's stock was owned by management, that the stock was not listed and was not dealt in generally by the public, and that management was unwilling to sell (List 184a, 191a-192a, 194a; Robinson 163a-164a, 165a-169a); he also knew the book value of the Fashion Park stock to be between $50 and $60 per share (List 194a; Robinson 163a). How-

ever, confirmation by Rosenberg, Jr. of management's unwillingness to sell is claimed by plaintiff to have triggered his sell order (Compl. ¶¶ 34, 35; Robinson 153a-154a, 168a; List 195a).

At a November 4, 1960 meeting of the board of directors of Fashion Park, which Lerner attended, Chatman for the first time told the board that he felt that Fashion Park was not providing full employment and so he intended to transfer approximately 300 to 350 (⅓) of the workers to another, undisclosed company. He further stated that he felt new management was essential to Fashion Park; that he (Chatman) knew someone who might buy if there was an interest in selling (Rosenberg, Jr. 118a; 87a—Pl. Exh. 2B; Stevenson 135a-136a). No names, no price was mentioned—although specifically requested (Chatman 149a, 150a-151a; Lerner 208a).

On November 14, 1960 Chatman privately told Rosenberg, Jr. that his prospective purchaser was the Hat Corp. (Rosenberg, Jr. 119a-120a; Chatman 148a, 150a; Stevenson 137a-138a). No one else was present at this meeting; Lerner was not informed thereof. (Chatman 151a; Rosenberg, Jr. 120a-121a.)

On November 16, 1960, Textile Shares telephoned Hentz and offered plaintiff's stock for sale. (105a—Adm. of Facts 5/31/62, ¶ 12.)

On November 17, 1960 Textile Shares sold the 5100 shares to Hentz (as broker) for $18.50 a share (160a—Adm. of Facts 5/31/62, ¶ 17).

At that time Hat Corp. had not even met the principals of Fashion Park; nor had Hat Corp. yet made any offer for the stock of Fashion Park. (107a—Adm. of Facts 5/31/62, ¶ 25.)

On or about November 22, 1960—five days *after* plaintiff's sale of his stock, the *first* exploratory talk was held between Fashion Park and Hat Corp. (Rosenberg, Jr. 121a-

123a; Stevenson 138a-139a). No offer or price was tendered at this meeting (*id.*) Lerner did not attend; nor was he informed thereof (*id.*).

On December 1, 1960—thirteen days *after* plaintiff's sale of his stock—Salesky, President of Hat Corp., came to Rochester. He met with the Rosenbergs and Stevenson, and orally offered $50 a share. The Rosenbergs were reluctant to sell, but agreed to consider the offer (Rosenberg, Jr. 123a-124a; Stevenson 139a-140a).

On December 4, 1960—seventeen days *after* plaintiff's sale of his stock—Rosenberg, Jr. telephoned Salesky and accepted the offer (Rosenberg, Jr. 124a; Stevenson 140a). Rosenberg, Jr. then—*for the first time*—telephoned Lerner and informed him of the deal (Rosenberg, Jr. 124a; Stevenson 141a). This was the first intimation Lerner had of any names, offers, prices or even negotiations for the sale of the Fashion Park stock (Rosenberg, Jr. 124a; Stevenson 141a).

On December 7, 1960 a preliminary agreement was signed (Rosenberg, Jr. 124a; Stevenson 141a; 97a—Pl. Exh. 7). Hat Corp. promptly issued a press release, disclosing the transaction (260a—Hentz Exhs. C, D; Green 233a-234a; Rosenberg, Jr. 124a-125a). On February 3, 1961 a definitive agreement was signed between the majority stockholders of Fashion Park and Hat Corp. (Rosenberg, Jr. 125a; Stevenson 141a; 251a—Lerner Exh. A).

Plaintiff commenced this action Feb. 24, 1961 at the instigation (Robinson 174a-176a; 108a—Pre-trial order 1/11/63, ¶ 3(a) 3; 253a—Lerner Exh. C) of his broker Robinson (of Textile Shares) who admits to a financial interest in any recovery, as a reward for such instigation (Robinson 176a-177a.)

Robinson will charge for his instigation and testimony only if plaintiff wins (Robinson 178a), and will give Seligson 20% *(id.)* of the $5000 Robinson expects (Robinson

177a). Robinson and Seligson had worked closely together (Seligson 222a), had conferred together before this suit was brought *(id.)*, and Seligson has yet to be paid (Robinson 178a).

Plaintiff's Hindsight

1. At trial, plaintiff professed to have first offered to sell his stock on November 16 or 17, 1960 (List 192a-193a). Yet the record established that plaintiff—at least since June 1, 1960—had actively sought such sale, at the same $20 price asked by Robinson of Green in November (Robinson 159a-160a). Thus:

(a) Robinson—who worked closely with Seligson (Seligson 222a)—told Seligson in May that Robinson's client had 5100 shares to sell at 20 (Robinson 180a; Seligson 214a-215a, 217a-218a). Robinson told Seligson the seller was plaintiff (Seligson 215a-216a, 218a).

(b) Although he first denied seeking a buyer (Seligson 216a-217a, 218a-219a, 222a-223a), Seligson was constrained to admit his efforts—as early as June 1—to sell plaintiff's stock to Sagner (Seligson 217a-218a, 219a; 256a—Exh. E) and Kittay (Seligson 217a-218a; 257a—Lerner Exh. F), and elsewhere (Seligson 223a-224a).

2. Plaintiff claimed he sold his stock in November 1960 only because the Rosenberg, Jr., October 31, 1960 letter to Seligson (95a—Pl. Exh. 5) convinced plaintiff the Rosenbergs would never sell. But the record showed:

(a) Plaintiff was told by Robinson, when plaintiff bought his stock in 1959, that the Rosenbergs were unwilling to sell (Robinson 165a-166a)—though from time to time Robinson, who certainly knew this (Robinson 165a-166a) denied telling plaintiff (Robinson 164a) or could not recall (Robinson 167a). Plaintiff himself was constrained to admit hearing from Robinson, early in 1959, that the

Rosenbergs were unwilling to sell (List 194a; Robinson 165a-166a).

(b) Seligson did not represent plaintiff (List 196a, 198a; Seligson 220a, 221a); nor had they ever met (List 197a-198a; Seligson 220a, 221a). Seligson was just a stranger, representing no one, trying to make a finder's fee (Seligson 219a, 220a, 221a).

(c) Rosenberg, Jr. wanted no part of this meddling stranger (Rosenberg, Jr. 127a). Nor does plaintiff "deal with strangers" (List 197a) who frequently approach him for the very same reason, to make a finder's fee (List 197a). Yet, without even ascertaining whether or not Seligson was a "stranger" to Fashion Park (List 197a-198a), and without himself determining whether the Rosenbergs would be willing to sell (List 196a), plaintiff would have one believe he sold because of reliance on the Rosenberg, Jr. letter to Seligson (95a—Pl. Exh. 5)—*with which letter no connection to Lerner is even claimed by plaintiff.*

3. Undisputed, albeit unwilling testimony shows that plaintiff sold his shares only because he could make a handsome 5 point profit on his 22 month investment. Thus:

(a) Between the time plaintiff bought at 13 in January, 1959 (Robinson 163a) and his sale in November, 1960, the only change in the Fashion Park picture was in the price of the stock—not the earnings, book value, nor the unwillingness of the Rosenbergs to sell (Robinson 167a-170a; Rosenberg, Jr. 117a-118a).

(b) After checking (Robinson 156a-157a) the rising price in the National Quotation Bureau's "sheets" (100a—Pl. Exh. 8), Robinson advised plaintiff "to get out of it at a nice profit" (Robinson 156a), suggesting that plaintiff sell "if he could get five points" (Robinson 161a). Plaintiff agreed, authorizing sale at 18 net (105a—Adm. of Facts 5/31/62, ¶ 11; List 186a).

(c) Although Robinson admitted that usually a broker with a "sell order" calls all the firms listed in the sheets to get the best price (Robinson 181a), he first denied doing so, saying he relied on Hentz (*id.*). Ultimately, Robinson admitted calling two other brokers in the sheets. Rice and Williams (Robinson 182a; 170a—Adm. of Facts 5/31/62, ¶ 9), as well as Caughlin, a broker in the sheets (170a—Adm. of Facts 5/31/62, ¶ 10) who was then director of Fashion Park (Robinson 171a). But Caughlin made no bid for the stock (*id.*).

(d) Plaintiff claims he would not have sold had he known Lerner, a director, was the buyer (List 56a, 59a), nor would he have sold had he known brokers who were directors had been bidding for the stock (List 200a). Yet plaintiff never restricted Robinson in selling, by forbidding sale to a director (List 199a); he didn't think such restriction important (List 201a). Nor did plaintiff ask Robinson to check whether any director was bidding in the sheets (List 200a). Only *price* was specified, not the type of buyer (108a—Pre-trial order 1/11/63, ¶¶ 3(a) 3; List 199a). Robinson vacillated between admitting and denying the importance of the existence of a director's bid in determining whether to sell (Robinson 170a-171a, 172a-173a); Robinson couldn't decide whether he did (Robinson 171a) or did not (Robinson 171a-173a) tell plaintiff directors were bidding. But Robinson was constrained to admit that Robinson knew two directors were bidding (Robinson 170a); that Robinson had offered plaintiff's stock to a broker, Caughlin, who was a director and was bidding (Robinson 171a); that Caughlin made Robinson no bid for the block (*id.*); and that the fact that two directors were bidding did not affect Robinson's judgment to sell—"not at that price" (*id.*). Plaintiff and Robinson each had the objective clear—a five point profit (Robinson 179a; List 186a, 199a).

The Surrounding Circumstances

The transaction in question was an impersonal one in the public over-the-counter market between two brokers, Textile Shares Corporation and H. Hentz & Co.; there was no direct contact between the principals (106a—Adm. of Facts 5/31/62, ¶¶ 17, 18, 19; Green 238a, 241a; Lerner 210a). Tens of thousands of such transactions occur daily in our public securities markets. But most crucial to this case is the fact that the transaction was finally consummated only as the result of solicitation by plaintiff 105a, 106a—Adm. of Facts 5/31/62, ¶¶ 11, 12, 13, 17). On November 16, 1960 plaintiff's broker called H. Hentz & Co. and solicited the purchase by Hentz of plaintiff's shares (105a—*id.*, ¶ 12). In response to plaintiff's solicitation, Hentz agreed with plaintiff's broker to try to place the shares and, seeking a customer, called Lerner (105a—*id.*, ¶¶ 12, 13), who had been in the sheets bidding for Fashion Park stock since 1955 (Lerner 246a). *Lerner thereupon refused the offered shares* (105a—Adm. of Facts 5/31/62, ¶ 13; Green 227a-228a). Only after several additional telephone calls and further solicitation of Hentz by plaintiff's broker, did Hentz (as broker) the following day purchase 5100 shares at $18.50 per share (106a—Adm. of Facts 5/31/62, ¶ 17; Green 227a-228a). Lerner purchased 4300 of these shares (152a-153a—Adm. of Facts 5/31/62, ¶ 20). What did Lerner then do with these 4300 shares? He retained only 1163 shares for his own account and promptly resold the balance of 3137 shares at a small profit (about $1 per share) to a variety of people including a publicly owned investment company in which he was a minority holder and a number of general accounts of customers' men in Lerner's office (106a—Adm. of Facts 5/31/62, ¶ 21; Lerner 211a-214a; 102a—Lerner Exh. H).

(If Lerner had had knowledge of a material fact which assured him a profit, is it likely that he would have resold

almost 75% of the shares purchase, for a mere $1 per share brokerage profit?)

These facts hardly substantiate an allegation that Lerner's "act, practice, or course of business" operated as a "fraud or deceit". A particularly strong showing of fraud is required in a case involving an impersonal transaction in the public over-the-counter market. See Daun and Phillips, *The Implications of Cady Roberts*, 17 Bus. Law. 939, 958 (1962). Of further, crucial importance to determination of whether fraud was practiced is the question of who initiated and solicited the transaction. As already demonstrated, Lerner's role was a passive one. *He* did not initiate or solicit this purchase. Lerner in fact initially refused the offered shares and was persuaded to make the purchase only after plaintiff's intensive selling efforts. Moreover, Lerner's immediate disposition, at a very small profit, of almost ¾ of the shares acquired by him is hardly consistent with a pattern of "fraud or deceit" on his part. The plaintiff in this case, Mr. Albert List, is a well-known financier who has invested in securities for 30 years, is president of a large corporation listed on the New York Stock Exchange, and is an experienced member of the financial community (List 187a-191a; 201a-203a; 254a—Lerner Exh. D). As the Court of Appeals for the Seventh Circuit has recently held, the business sophistication of a seller claiming fraud under Rule X-10B-5 is a most significant factor in determining whether defendant practiced fraud upon the seller. *Kohler* v. *Kohler Co.*, CCH Fed. Sec. L. Rep. pars. 91,243, page 94118 (7th Cir. 1963). It is hardly possible to imagine a person with greater business sophistication than Albert List (See Barron's, August 5, 1963, p. 3, *Midas Touch? Albert List Apparently Can Make Money from Anthracite or Almost Anything Else,* 254a—Lerner Exh. D). Is it likely that he would have failed to make due inquiry as to the material facts, before ordering his stock sold?

The Buyer's Identity

The usual practice among securities brokers is not to reveal the names of their customers to other brokers with whom they deal (106a—Adm. of Facts 5/31/62, ¶ 19). Robinson, who has acted for plaintiff on a number of occasions over the past 17 years (Robinson 45a-46a, 153a), testified that he has never violated this rule (Robinson 162a), and Robinson has been a broker since 1919 (*id.*). Plaintiff himself did not ask the identity of the buyer (108a—Pre-trial order 1/11/63, ¶ 3(a)3); nor whether he was an officer or director of Fashion Park (108a—Pre-trial order 1/11/63, ¶ 3(a)2; Robinson 173a-174a); nor had he asked the seller's name when he first bought the stock (108a—Pre-trial order 1/11/63, ¶ 3(a)1; List 192a; Robinson 162a). Clearly, plaintiff did not consider such information to be material.

Reasons for Denying the Writ

1. The decision of the District Court, was based on findings of fact adverse to plaintiff; such findings were sustained by the Court of Appeals, and do not warrant review.

2. The decisions below do not conflict with the decision of this Court in *SEC* v. *Capital Gains*, 375 U. S. 180 (1963), nor with *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951) and *Strong* v. *Repide*, 213 U. S. 419 (1908). The latter two cases are fully discussed in the opinions below. The *Capital Gains* decision—where an injunction was sought under similar provisions of the Investment Advisors Act of 1940—concerned an active misrepresentation; the investment advisor, while recommending stocks for purchase by his clients, concealed his personal recent purchase of such securities, for profitable resale when the clients' later purchases would cause a price rise (a practice known

as "scalping"). The Court of Appeals properly distinguished this decision as an administrative proceeding designed to deter misconduct, unlike a personal claim for damages.

CONCLUSION

The decisions below were predicated upon findings of fact amply supported by the record. There is here presented no question of law warranting review by this Court. Accordingly, the petition for certiorari should be denied.

Respectfully submitted,

LEONARD I. SCHREIBER,
Attorney for Respondent Lerner.

LIBRARY
SUPREME COURT U.S.

Office-Supreme Court, U.S.
FILED
APR 23 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1965

No. 66

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of LERNER & COMPANY, and as a Director of FASHION PARK, INC.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. HENTZ & CO., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

BRIEF OF RESPONDENTS H. HENTZ & CO. and WILLIAM P. GREEN IN OPPOSITION

WILLIAM E. FRIEDMAN
Attorney for Respondents
H. Hentz & Co. and William P. Green
70 Pine Street
New York, New York 10005

STEPHEN F. SELIG
NORMAN I. KLEIN
Of Counsel

TABLE OF CONTENTS

	PAGE
THE OPINIONS BELOW	1
JURISDICTION	2
THE QUESTION PRESENTED	2
STATEMENT OF THE CASE	2
ARGUMENT	5
I—The determination by the Court of Appeals is not in conflict with decisions of this Court or with decisions of Courts of Appeals of other Circuits, does not raise any substantial Federal issue and is clearly correct	5
II—The findings of fact made by the Trial Court and affirmed by the Court of Appeals are amply supported by the record and should not be subject to further review	9
III—The Court of Appeals correctly declined to consider the newly raised issue of price misrepresentation and, in any event, there was no evidence to support such issue	11
CONCLUSION	13

TABLE OF AUTHORITIES

Cases:

Charles Hughes & Co., Inc. v. SEC, 139 F. 2d 434 (2 Cir. 1943)	7
Graver Tank & Mfg. Co., Inc. *et al.* v. Linde Air Products Co., 336 U. S. 271, 69 S. Ct. 535 (1949)	9

PAGE

James Blackstone Memorial Library Ass'n v. Gulf, Mobile & Ohio R. R. Co., 264 F. 2d 445 (7 Cir. 1959) cert. denied 361 U. S. 815 (1959) 11

Kardon v. National Gypsum Co., 73 F. Supp. 798 (E. D. Pa., 1947), 83 F. Supp. 613 (E. D. Pa. 1947) 6, 7, 8

Kohler v. Kohler Co., 208 F. Supp. 808 (E. D. Wis. 1962) aff'd, 319 F. 2d 634 (7 Cir. 1963) 6, 11

Mills v. Sarjem Corporation, 133 F. Supp. 753 (D. N. J. 1955) 6

Reed v. Riddle Airlines, 266 F. 2d 314 (5 Cir. 1959) 6

Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U. S. 180, 84 S. Ct. 275 (1963) 7

Speed v. Transamerica Corp., 5 F. R. D. 56 (D. Del. 1945); 99 F. Supp. 808 (D. Del. 1951) 6, 7, 8

Strong v. Repide, 213 U. S. 419, 29 S. Ct. 521 (1909) 7, 8

Statutes and Rules:

Federal Rules of Civil Procedure, Rule 15(b) 11

Federal Rules of Civil Procedure, Rule 52(a) 11

Securities Act of 1933 §12(2) (15 USC §77l(2)) 6, 7

Securities Exchange Act of 1934 §10(b) (15 USC §78j (b)) 2-3, 6, 7, 8

28 USC §1254(1) 2

Rules of the Securities and Exchange Commission, Rule 10b-5 ..... 3, 5, 6, 7

Other:

III Loss, Securities Regulation (2d Ed., 1961) pp. 1438-1439; 1702; 1761 *et seq.*; 1765-66 ..... 7; 6

IN THE

Supreme Court of the United States

October Term, 1964

No. 1027

ALBERT A. LIST,

Petitioner,

against

LOUIS C. LERNER, individually and as doing business under the firm name and style of LERNER & COMPANY, and as a Director of FASHION PARK, INC.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLAK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. HENTZ & CO., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

BRIEF OF RESPONDENTS H. HENTZ & CO. and WILLIAM P. GREEN IN OPPOSITION

Opinions Below

The Opinion of the District Court for the Southern District of New York is reported at 227 F. Supp. 906. The Opinion of the Court of Appeals for the Second Circuit is reported at 340 F. 2d 457.

Jurisdiction

The judgment of the Court of Appeals affirming the decision of the Trial Court was entered on January 4, 1965. The petition for a writ of certiorari was filed March 30, 1965. Petitioner invokes the jurisdiction of this Court under 28 USC §1254 (1).

The Question Presented

Should this Court invoke its certiorari jurisdiction in this case:

(a) Where the Court of Appeals found that factual determinations of the Trial Court were fully supported by the record and were not "clearly erroneous," and

(b) Where the decision of the Court of Appeals is not in conflict with any decisions of this Court or other Circuit Courts of Appeals and does not raise any substantial Federal question.

Statement of the Case

Petitioner, who purchased 5,100 shares of common stock of Fashion Park, Inc. in January, 1959 and sold them at a profit of over $25,000 on November 17, 1960, brought this action against several defendants, including H. Hentz & Co. ("Hentz"), a brokerage firm which acted as broker for the purchasers of petitioner's stock, and William P. Green ("Green"), a general partner of Hentz. His claim was that the defendants violated Section 10(b) of the

Securities Exchange Act of 1934 (15 USC §78j(b)) and Rule 10b-5 promulgated thereunder by not disclosing the following facts to him at the time he sold his Fashion Park, Inc. common stock:

1. That respondent Louis Lerner, the purchaser of 4,300 shares of petitioner's stock, was a director of Fashion Park, Inc.

2. That on November 4, 1960, the directors of Fashion Park, Inc. adopted a resolution to the effect that the Company should be sold or merged; and

3. That Hat Corporation of America, which offered to purchase all shares of Fashion Park, Inc. common stock at $50 per share, pursuant to an agreement made with the controlling shareholders of Fashion Park, Inc. in February, 1961, had expressed an interest in Fashion Park, Inc. prior to November 17, 1960.

In the Court of Appeals petitioner advanced for the first time the argument that the purchasers' willingness to buy his stock at $18.50 per share constituted a representation that the shares were then worth $18.50 per share, when they were worth more.

Petitioner sought damages of $160,150, the difference between the price ($18.50 per share) at which he sold his Fashion Park, Inc. common stock and the price ($50 per share) offered for all such shares by Hat Corporation of America pursuant to the February 1961 agreement.

The facts, which are largely undisputed, are cogently set forth in the opinion of the Court of Appeals (App. Pet.

3-5)* and in respondent Lerner's brief in opposition and shall not be repeated here. We will restrict ourselves to noting that the Trial Court found that, at the time petitioner sold his stock, Hentz had no knowledge of the November 4, 1960 resolution or the pre-November 17, 1960 interest of Hat Corporation of America (P. App. 22a) and to pointing out the numerous unsupported and inaccurate statements in petitioner's statement of the case.

Petitioner asserts that "defendants" purchased petitioner's stock. Hentz did not; it acted solely as broker for the purchaser (P. App. 7a, App. Pet. 5).

Petitioner charges that "defendants arranged to sell" petitioner's stock to Hat Corporation of America at $50 per share approximately three weeks after he sold his stock. Hentz and Green had absolutely no role in the transaction between Fashion Park, Inc. and Hat Corporation of America or the negotiations leading to that transaction (which were not even undertaken until after November 17, 1960). The agreement between these parties was not reached until February, 1961 (not December, 1960) and Hentz and Green had no knowledge of the purchase price until February, 1961 (R. App. 119a-125a, 138a-140a, 144a-145a).

Petitioner alleges that defendants had certain inside information which they failed to disclose to him, which nondisclosure induced him to sell his stock. The record is undisputed that Hentz and Green knew only that Lerner was

* References herein will be made as follows: Petitioner's Appendix—"P. App.", Respondents' Appendix—"R. App.", Appendix to Petition for writ—"App. Pet.", Petition for writ—"Pet."

a director of Fashion Park, Inc. and both the Trial Court and the Court of Appeals found that the other facts to which petitioner alludes were not material facts. As to Lerner's identity, it was found that petitioner would have sold even if he knew that Lerner was a purchaser (P. App. 16a, App. Pet. 12-13).

Petitioner now asks this court to review these as well as the other factual determinations which the Trial Court resolved in favor of respondents and which the Court of Appeals found to be fully supported by the record.

ARGUMENT

I

The determination by the Court of Appeals is not in conflict with decisions of this Court or with decisions of Courts of Appeals of other Circuits, does not raise any substantial Federal question and is clearly correct.

The Court of Appeals held that the common law elements of "materiality" and "reliance" are carried over into civil fraud actions under Rule 10b-5 and that a plaintiff, to prevail in such an action, must establish both elements. The court defined these terms as follows:

"'Materiality' encompasses those facts which 'in reasonable and objective contemplation might affect the value of the corporation's stock or securities * * *'" (App. Pet. 10).

The test of reliance is "* * * whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact * * *" (App. Pet. 11).

To support these conclusions the Court of Appeals relied upon *Reed* v. *Riddle Airlines*, 266 F. 2d 314, 319 (5 Cir. 1959); *Kohler* v. *Kohler Co.*, 208 F. Supp. 808, 823 (E. D. Wis. 1962), *aff'd*, 319 F. 2d 634 (7 Cir. 1963); *Mills* v. *Sarjem Corporation*, 133 F. Supp. 753, 767 (D. N. J. 1955); *Speed* v. *Transamerica Corp.*, 5 F. R. D. 56, 60 (D. Del. 1945); *accord*, III Loss, Securities Regulation 1765-66; *Kardon* v. *National Gypsum Co.*, 73 F. Supp. 798, 800 (E. D. Pa. 1947).

Petitioner argues that to require a plaintiff to prove reliance (i.e., that there is a causal connection between the alleged wrong and his injury) destroys the intent of the Securities Exchange Act of 1934 and is contrary to decisions of this Court and the Court of Appeals for the Third Circuit (Pet. 4-5, 12-13). He is wrong.

The Securities Exchange Act of 1934 does not expressly provide for civil suits based on violations of Section 10b or Rule 10b-5; this remedy was created by the courts (*Kardon* v. *National Gypsum Co., supra;* III Loss, Securities Regulation, 1761 *et seq.*). Thus, there is absolutely no basis for petitioner's assertion that requiring a plaintiff to establish his reliance on an alleged misrepresentation or omission is contrary to Congressional intent. Further, when Congress intended to eliminate reliance as an element of a civil cause of action based on the Federal securities laws, it did so: Section 12(2) of the Securities Act of 1933

(15 USC 77l(2)) makes any person, who sells a security by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact, liable to the buyer, unless the seller can establish that he did not know and in the exercise of reasonable care could not know of such untruth or omission. Petitioner's reference (Pet. 12) to page 1702 of Professor Loss' treatise in which it is stated that reliance need not be proven deals with Section 12(2) and not with Section 10(b) or Rule 10b-5.

Similarly, *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 84 S. Ct. 275 (1963) has no bearing on the case at bar. That case involved an attempt by the SEC to enjoin "scalping" by a registered investment advisor. It is obvious that in such a proceeding, or in administrative disciplinary proceedings brought by the Commission to prevent or punish unlawful conduct, rather than to compensate persons damaged by such conduct, it is immaterial whether anyone was in fact victimized, and there is no need to show any causal connection between the act complained of and the injury resulting therefrom. Thus, petitioner's reliance on *Charles Hughes & Co., Inc.* v. *SEC*, 139 F. 2d 434 (2 Cir. 1943), other cases involving SEC disciplinary proceedings and pages 1438-1439 of Professor Loss' treatise is equally misplaced.

Further, the Court of Appeals decision in this case is not in conflict with *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951), *Kardon* v. *National Gypsum Co., supra;* 83 F. Supp. 613 (E. D. Pa. 1947) or *Strong* v. *Repide*, 213 U. S. 419, 29 S. Ct. 521 (1909).

In *Speed,* plaintiffs expressly alleged that they relied upon the untrue statements there involved (page 812) and the decision in an earlier phase of the same case (5 F. R. D. 56, 60) shows that a class action was allowed because the court was convinced that there was such reliance by all of plaintiffs. The Court of Appeals here did not impose a more stringent test.

In *Kardon,* the court apparently found that plaintiffs did rely on an express misrepresentation by defendants (83 F. Supp. at 614) and any statement to the contrary is, at best, dictum.

Similarly, in *Repide,* while the sole issue before this Court was whether a corporate insider was under a duty to disclose certain information to the seller of stock in that corporation, this Court did point out that there was ample evidence in the record to establish that because of defendant's concealing certain facts plaintiff was induced to sell her stock when otherwise she would not have done so (213 U. S. at 428-30). This is but another way of saying that there was reliance.

It is seen, therefore, that the principles enunciated by the Court of Appeals do not vitiate the purposes of the Securities Exchange Act of 1934, are not in conflict with any decisions of this Court or of any other Circuit Court, and are in fact clearly correct.

II

The findings of fact made by the Trial Court and affirmed by the Court of Appeals are amply supported by the record and should not be subject to further review.

Much of the petition is devoted to attacks on the factual determinations made by the Trial Court and affirmed by the Court of Appeals (e.g., pages 8, 9, 11, 12, 16-18, 18-19, 20 and 22-24). However, factual issues which have been passed upon by two courts should not again be reviewed by this Court (*Graver Tank & Mfg. Co., Inc.* v. *Linde Air Products Co.*, 336 U. S. 271, 69 S. Ct. 534 (1949)). There this Court held:

> "A court of law, such as this Court is, rather than a court for corrections of errors in fact finding, cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error." (citing many cases) 336 U. S. at 275, 69 S. Ct. at 538.

Here, no such error is or can be shown for the findings of fact made below are more than amply supported by the record.

Thus, the Trial Court concluded that petitioner would have sold his Fashion Park, Inc. stock even if he knew that Lerner, a Fashion Park director, was one of the buyers. It based this result on its findings (upheld by the Court of Appeals) that

> "* * * [P]laintiff is an experienced and successful investor in securities; that he actively solicited the sale

to defendants; that he did not ask his broker whether any insiders were bidding for stock in the corporation; that his broker knew two directors were bidding but did not think it necessary to inform plaintiff of this; that the only restriction plaintiff placed on his broker related to price; and that his broker suggested that five points would be a nice profit, to which plaintiff agreed. From these facts, the trial court presumably inferred that plaintiff was so desirous of 'the potential five point profit he would make' and so reliant on knowledge acquired through 'his many dealings in the securities field' that the identity of the buyer would have been of little or no concern to him." (App. Pet. 12-13)

Similarly, the Trial Court concluded that the adoption of the November 4, 1960 resolution and the setting in which it occurred were not material facts that should have been disclosed to petitioner. This result was based in part "* * * on the undisputed facts that at the time the resolution was adopted the Fashion Park directors only had before them the statement of the union manager that he knew of some unidentified person who would be interested in buying Fashion Park; that by the time plaintiff sold his stock on November 17, 1960 nothing more had occurred except that the president of Fashion Park had learned the name of the potential purchaser; and that within two weeks after he bought plaintiff's stock defendant Lerner disposed of part or all of his interest in 3137 of his 4300 shares at an average profit of only about $1 per share. The trial court presumably inferred from these facts that the prospects for 'a sale of Fashion Park' and for a sale at a price 'profitable to shareholders,' insofar as Lerner and the other defendants apprehended them to be at the time they

purchased plaintiff's stock, were too remote to have influenced the conduct of a reasonable investor." (App. Pet. 13-14)

Again the Court of Appeals upheld these determinations. *James Blackstone Memorial Library Assn.* v. *Gulf, Mobile & Ohio R. R. Co.*, 264 F. 2d 445 (7 Cir., 1959), cert. denied 361 U. S. 815 (1959); *Kohler* v. *Kohler Co.*, *supra.*

We submit that petitioner should not be heard now to argue that if his evidence (rejected by two courts) had been accepted he could prevail. (Fed. R. Civ. Proc. 52 (a))

III

The Court of Appeals correctly declined to consider the newly raised issue of price misrepresentation and, in any event, there was no evidence to support such issue.

Neither plaintiff's complaint nor the pre-trial order defining the issues for trial in this action made the slightest mention of any claim that the purchase of petitioner's stock at $18.50 per share constituted an implied representation that his stock was worth that price on the day of sale or that such a representation was false (R. App. 108a-109a). Similarly, petitioner made no attempt either at the trial or at its conclusion to amend his pleadings to allege such a charge (see Fed. R. Civ. Proc. 15(b)). In these circumstances, the Court of Appeals correctly declined to pass on such issue, raised for the first time on appeal.

In addition, there is no evidence in the record to show that on November 17, 1960, the day petitioner sold his stock, the value of that stock was other than $18.50 per share. The record is clear that petitioner, through his broker, offered his stock in the open market at a price of $20 per share on November 16, 1960 and, after negotiations, sold those shares at a price of $18.50 on the following day. On those days, the market price for Fashion Park stock as shown by the National Quotation Bureau sheets (P. App. 101a) was $16-$19 and $16-$18, respectively.

Notwithstanding petitioner's failure to raise this issue on trial, he now alludes to three so-called facts which he claims the Trial Court could have relied upon to find the "fair value" of petitioner's stock (Pet. 23-24): the $50 per share received by the Fashion Park shareholders from Hat Corporation of America under the agreement of February, 1961, the book value of the stock, and Fashion Park's annual report for 1959. The latter two facts were fully known to petitioner when he sought to sell his stock (R. App. 192a, 198a), and the price which Hat Corporation of America was offering was not disclosed until February, 1961 and was not known by Hentz and Green until that time (R. App. 233a-234a, 238a-240a).

It follows necessarily that this claim is at best a belated makeweight devoid of merit.

Conclusion

The decisions below, which were based on findings of fact fully supported by the record, are consistent with the purposes of the Securities Exchange Act of 1934 and decisions of this Court and other Circuit Courts. The petition for certiorari should be denied.

Respectfully submitted,

WILLIAM E. FRIEDMAN
Attorney for Respondents
H. Hentz & Co. and William P. Green

STEPHEN F. SELIG
NORMAN I. KLEIN
Of Counsel

LIBRARY
SUPREME COURT, U. S.

No. 66

Office-Supreme Court, U.S.
FILED
MAY 12 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1965

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLACK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

PETITIONER'S REPLY MEMORANDUM

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.
152 WEST 42ND STREET
NEW YORK, NEW YORK

Of Counsel,
O'BRIEN, DRISCOLL & RAFTERY.

TABLE OF CONTENTS

	PAGE
The Decision Below Is Contrary to Decisions of This Court	4
The Decision Below Conflicts With Decisions of Other Circuits	6
The Decision Below Is Contrary to Opinions of the S.E.C.	7
The Decision Below Is Contrary to the Intent of Congress	8
The Decision Below Is Contrary to the Views of Commentators on the Subject	9
The Decision Below Conflicts With Other Holdings of the Second Circuit Itself	10

CASES CITED

Archer v. Securities & Exchange Comm'n, 133 F. 2d 795 (C. A. 8th Cir.), cert. denied, 319 U. S. 767	6
Arleen Hughes v. Securities & Exchange Comm'n, 174 Fed. 2d 969 (C.A.D.C. Cir.)	6
Charles Hughes & Co. v. Securities & Exchange Comm'n 139 F. 2d 434, cert. denied, 321 U. S. 786	10
In the Matter of Cady, Roberts & Co., 40 S.E.C. 907 (1961)	7
In the Matter of Ward La France, 13 S.E.C. 373, 380, 381 (1943)	8

PAGE

J. I. Case Co. v. Borak, 377 U. S. 426 (1964) 8

Kardon v. National Gypsum Co., 73 Fed. Supp. 798 (E. D. Pa. 1947) 7

Mosser v. Darrow, 341 U. S. 267, 271, 95 L. Ed. 927, 932, 71 S. Ct. 680 5

N. Sims Organ Co. v. The Securities and Exchange Commission, 293 Fed. 2d 78 10

Norris & Hirshberg v. Securities & Exchange Comm'n, 177 F. 2d 228 (C.A.D.C. Cir.) 7

S.E.C. v. Capital Gains Research Bureau, 375 U. S. 180 .....2, 3, 4, 6, 7, 9

Speed v. Transamerica Corp., 235 F. 2d 369 (C. A. 3d Cir.) 7

Strong v. Repide, 213 U. S. 419 6

STATUTES CITED

Investment Advisers Act of 1940 .....4, 6, 8

Securities Exchange Act,

Section 17(a) 7

Section 10(b) 1, 7, 9

Rule 10b5 7

Section 15(c)(1) 9

Securities Act of 1933 8

Trust Indenture Act of 1939 8

PAGE

MISCELLANEOUS

H. R. Rep. No. 85, 73rd Cong. 1st Sess. 8

Shulman, Civil Liability and the Securities Act, 43 Yale L. J. 227 8

Report of Special Study of Securities Markets of the Securities and Exchange Commission, H. R. Doc. No. 95, 88th Cong., 1st Sess. (1963) 8

Loss, Securities Regulation at pages 1438, 1439, 1452, 1702 9

Fleischer, Federal Corporation Law 9

Knauss, A Reappraisal of the Rule of Disclosures, 62 Mich. Law Review, 607, 614 (1964) 9

78 Harv. Law Rev. 9

IN THE

Supreme Court of the United States

OCTOBER TERM 1964

No. 1027

LOUIS C. LERNER, individually and as doing business under the firm name and style of Lerner & Company, and as a Director of Fashion Park, Inc.,

JEROME LEWINE, EDMUND W. FITZGERALD, ARTHUR S. NEUMARK, ROBERT PARKES BARUCH, LEWIS D. RAABIN, E. MILO GREENE, STANLEY HESSE, WALTER CAMPBELL GIBSON, HENRY A. ZOELLER, ROBERT POLLACK, JEROME LEWINE, JR., ALVIN SCHONFELD, ARTHUR MORRIS, GERSON D. LUBLIN, WILLIAM P. GREEN, MORRIS HOFFENBERG, NORMA P. LEWINE, JACOB SCHONFELD, MARINA BARUCH DOYLE, LEO M. C. OLIVER, JULIAN BLASS, FLORENCE S. CLAYTON, HATTIE G. MORRIS and HELEN F. SPOONER, doing business under the firm name and style of H. Hentz & Co., a co-partnership, and WILLIAM P. GREEN, individually,

Respondents,

FASHION PARK, INC., *et al.*,

Defendants.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

PETITIONER'S REPLY MEMORANDUM

Petitioner sued under Section 10(b) of the Securities Exchange Act to recover from a director-insider profits realized by him on a resale of stock shortly after his purchase from plaintiff. Petitioner relied below on the non-

disclosure by the director (1) of his insider capacity and (2) of the fact that an important change had occurred in the corporate business affecting the value of the stock. The courts below interpreted the Act to require proof not only of "non-disclosure" of a material fact but also "reliance" by the plaintiff and dismissed the complaint, saying:

> "Disagreement centers on the applicability and meaning of the requirement that *reliance* be placed upon the misrepresentation. Our examination of the authorities satisfies us that this requirement also is carried over into civil suits under Rule 10b-5." (Opinion below, p. 582)

Petitioner urges that review by this Court of such holding is of great importance to the investing public and the financial community. Particularly is this true in view of the prominence given in the public press recently to the action instituted by the Securities Exchange Commission against the directors of the Texas Gulf Sulphur Company. For example, the New York Times of Sunday, April 25th said of that action:

> "The commission, by its action * * * appears to be saying that a director of a company has an obligation not to act on inside news until he is sure that it has reached the public. The commission takes the view that it served notice to this effect in the Cady, Roberts case."

A similar question was deemed by this Court to be of sufficient importance for certiorari to be granted in *S.E.C.* v. *Capital Gains Research Bureau*, 375 U. S. 180. In that case the action was one described by the Court to be of an equitable or prophylactic action. This case is in the area apparently left open by *Capital Gains*, viz., the application of the rationale of that decision to a private suit at law for damages, including a determination of whether it is

desirable to apply common law "doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth * * * to the sale of such intangibles as * * * securities * * *." (*S.E.C.* v. *Capital Gains Bureau,* at p. 194.)

This Court should settle the question of the applicability to private suits at law of the Commission's philosophy of full disclosure as upheld in *Capital Gains* and as announced to the public in the Texas Gulf Sulphur situation under the very Statute here involved. Particularly is this true in a case involving Section 10b and Rule 10b-5 which potentially have such enormous importance to a substantial segment of the financial community and the investing public. In the words of the author of the Harvard Law Review article referred to, *infra,* page 9,

> "The Court's sweeping language [in *Capital Gains*] in holding § (2) irrelevant will have as yet undetermined effects on private actions under 10b-5, where the law is already unclear as to the need for *scienter.*" (78 Harvard Law Review (p. 295 n. 29))

Petitioner also urges that certiorari should be granted because the opinion below appears to be contrary to the express intent of Congress, to conflict with the import of decisions of this Court, decisions in other circuits, published opinions of the Commission, views of commentators, and indeed, opinions of the Second Circuit itself in other cases.

For the purpose of this application the factual findings below are accepted and it is not urged, as suggested by respondents' briefs, that this Court review such factual findings. Rather, it is urged that under the admitted facts that (a) defendant Lerner was at all material times a director of Fashion Park, Inc., and (b) there was a failure to disclose the adoption of the Board resolution of November 4, 1960 to the effect that Fashion Park, Inc. must merge

or sell to survive, there exists such a violation of the anti-fraud statute as permits recovery without further proof.

The Decision Below Is Contrary to Decisions of This Court

Petitioner reads this Court's opinion in *Capital Gains* as imposing absolute liability on an insider-director to disclose any material information which the insider possesses when the insider is purchasing stock from an outside stockholder. Such disclosure should have been not merely of Lerner's identity. In this case, on the admitted facts, Lerner, the insider-director failed to disclose to List that at a meeting of Fashion Park directors held November 4, 1960, in which he himself had participated, the Directors voted to sell or merge the business of Fashion Park to correct the corporation's hopeless financial condition which Lerner said "was literally forcing the company out of business" (208a). It is submitted that a logical extension of the opinion in *Capital Gains* imposes the absolute liability for which petitioner here contends in a private suit for damages such as this as well as in equitable suits by the Commission. Even Justice Harlan, in his dissent in *Capital Gains,* acknowledged that the majority had adopted an "absolute rule of disclosure". (Justice Harlan's dissent at p. 206.)

Examination of the language of the majority opinion of Justice Goldberg in *Capital Gains* compels the conclusion that the legal philosophy he so painstakingly formulated there is neither confined in its application to equitable actions by the Commission nor to cases arising under the Investment Advisers Act of 1940. Thus, Justice Goldberg states (p. 200):

> "This, of course, is but another way of putting the rejected argument that the elements of technical common-

law fraud—particularly intent—must be established before an injunction requiring disclosure may be ordered. It is the practice itself, however, with its potential for abuse, which 'operates as a fraud or deceit' within the meaning of the Act when relevant information is suppressed.

* * * Failure to disclose material facts must be deemed fraud or deceit within its intended meaning, for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive. To impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute. * * * The statute, in recognization of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statue to confine its application to 'dishonest' as opposed to 'honest' motives. As Dean Shulman said in discussing the nature of securities transactions, what is required is 'a picture not simply of the show window, but of the entire store * * * not simply truth in the statements volunteered, but disclosure.' The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients.

Experience has shown that disclosure in such situations, while not onerous to the adviser, is needed to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economic health of the country."

Petitioner argues here that Congress's intent was to require an equally broad remedial construction of Section 10b in actions of a similar nature against corporate insiders, so that recovery could be had for non-disclosure by that corporate insider of the material facts unimpeded by narrow technical common law requirements such as "the reliance" imposed on petitioner by the Court below. Indeed the statute here involved appears to impose a greater duty than the Investment Company Act provision in *Capital Gains.*

Petitioner argues that the Court below misapplied the provisions of the 1934 Act just as this Court said the same Court had erred in construing the Investment Advisers Act of 1940 and "by requiring proof of 'misstatements', unsound advice, bribery, or intent to unload 'worthless stock', the court read the statute, in effect, as confined by traditional common-law concepts of fraud and deceit." (*S.E.C.* v. *Capital Gains Bureau,* footnote 6.)

It would appear to be sheer sophistry to argue that petitioner should have proved his reliance on something that was not in fact disclosed to him.

In the petition for certiorari reliance was also placed on asserted conflict between the decision below and *Strong* v. *Repide,* 213 U. S. 419. Respondents challenge the asserted conflict in their briefs in opposition. Petitioner urges the continued vitality of *Strong* v. *Repide* and its applicability in this case.

The Decision Below Conflicts With Decisions of Other Circuits

Petitioner urges that the decision below conflicts with the decisions in other circuits such as *Archer* v. *Securities & Exchange Comm'n,* 133 F. 2d 795 (C. A. 8th Cir.), cert. denied, 319 U. S. 767; *Arleen Hughes* v. *Securities & Ex-*

change Comm'n, 174 Fed. 2d 969 (C.A.D.C. Cir.); *Norris & Hirshberg* v. *Securities & Exchange Comm'n*, 177 F. 2d 228 (C.A.D.C. Cir.); *Speed* v. *Transamerica Corp.*, 235 F. 2d 369 (C. A. 3d Cir.); *Kardon* v. *National Gypsum Co.*, 73 Fed. Supp. 798 (E. D. Pa. 1947).

Respondents' briefs in opposition disputed this asserted conflict. That there is such a conflict, however, is apparent from the citation of the foregoing cases (except for the *Kardon* case) by Justice Goldberg in footnote 52 of his opinion in *Capital Gains* and by the fact that Justice Harlan in his dissent undertook to distinguish the cases, thereby recognizing that they form one of the pillars upon which the majority opinion in *Capital Gains* rested, even though he, as distingiushed from the majority, concluded that they were not applicable.

The Decision Below Is Contrary to Opinions of the S.E.C.

The Commission, in its opinion *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), said (pp. 910-911):

> "* * * The purchase and sale of securities is a field in special need of regulation for the protection of investors. To this end one of the major purposes of the Securities acts is the prevention of fraud, manipulation or deceit in connection with securities transactions. Consistent with this objective, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b5 issued under that Section are broad remedial provisions aimed at reaching misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit."
>
> "An affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders', particularly officers, directors, or controlling

> stockholders. We and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment. Failure to make disclosure in these circumstances constitutes violation of the anti-fraud provisions."

To the same effect is an earlier opinion, *In the Matter of Ward La France,* 13 SEC 373, 380, 381 (1943).

The Decision Below Is Contrary to the Intent of Congress

Congress, in the enactment of the Securities Act of 1933, the Securities Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Advisers Act of 1940, had as a fundamental purpose, common to these statutes, the substitution of a philosophy of full disclosure for the philosophy of *caveat emptor* so as to achieve a high standard of business ethics in the Securities industry (H. R. Rep. No. 85, 73rd Cong. 1st Sess.). See also Shulman, Civil Liability and the Securities Act, 43 Yale L. J. 227.

As this Court said in *J. I. Case Co.* v. *Borak,* 377 U. S. 426 (1964):

> "It is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."

Congress has only recently reaffirmed the importance it placed on disclosure. Thus, in the Report of Special Study of Securities Markets of the Securities and Exchange Commission, H. R. Doc. No. 95, 88th Cong., 1st Sess, (1963) it was said "The keystone of the entire structure of Federal securities legislature is disclosure."

See also Loss, "Securities Regulation" at pages 1438, 1439, 1452, 1456, 1702.

The Decision Below Is Contrary to the Views of Commentators on the Subject

In Fleischer, *Federal Corporation Law: An Assessment,* 78 Harv. L. R. 1146, it is said:

> "* * * It would seem clear that the securities laws should not be given restrictive readings, and that Congress desired the federal anti-fraud provisions, for example, to be free of the ancient and illogical distinctions that at the time haunted state fraud law. And so the courts have read the congressional intent. In early decisions involving the securities laws the Supreme Court spoke of the need to interpret such remedial legislation in a fashion not to frustrate its purposes. That this congenial view has continued to the present appears from the *Capital Gains* and *Borak* decisions."

Similar views were expressed in an article by Knauss, *A Reappraisal of the Rule of Disclosures,* 62 Mich. Law Review, 607, 614 (1964).

> "The underlying theory is essentially that, given adequate information, the law of supply and demand, combined with action by each purchaser for his own best interest, will establish a true market value for a security."

In a review in 78 Harv. Law Rev. of the decisions of the Supreme Court, 1963 Term, it is said in the section dealing with decisions of the Court in the field of Securities Regulations:

> "Sections 10(b) and 15(c)(1) of the Securities Exchange Act, which proscribe fraud without mention-

ing omissions, have been implemented by Commission rules, enforced by the courts, which do prohibit omissions of material facts." (p. 295)

The Decision Below Conflicts With Other Holdings of the Second Circuit Itself

The Second Circuit in its decision in 1961 in *N Sims. Organ Co.* v. *The Securities and Exchange Commission,* 293 Fed. 2d 78, had held that reliance was not an element in the violation of the 1934 Act involved in that case. Moreover, in *Charles Hughes & Co.* v. *Securities & Exchange Comm'n,* 139 F. 2d 434, cert. denied, 321 U. S. 786 nondisclosure was treated by the Second Circuit as one variety of fraud or deceit.

May, 1965.

Respectfully submitted,

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.

Of Counsel:

O'BRIEN, DRISCOLL & RAFTERY.

INDEX

	Page
Statement	1
Discussion	4
Appendix	11

CITATIONS

Cases:

Cody, Roberts & Co., 40 S.E.C. 907 — 8

J. I. Case Co. v. *Borak*, 377 U.S. 426 — 5

Speed v. *Transamerica Corporation*, 99 F. Supp. 808, affirmed, 235 F. 2d 369 — 6

Statute and rule:

Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78a, *et seq.*:

Section 10(b), 15 U.S.C. 78j(b) — 1, 4, 5, 7, 11

S.E.C. Rules and Regulations under the Securities Exchange Act of 1934, 17 CFR 240.0–1, *et seq.*:

Rule 10b–5, 17 CFR 240.10b–5 — 1, 4, 5, 6, 7, 11

Miscellaneous:

Fleischer, *"Federal Corporation Law": An Assessment*, 78 Harv. L. Rev. 1146 (1965) — 5

Prosser, *Handbook of the Law of Torts* (2d Ed.) — 7

784-100—65

In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 66

ALBERT A. LIST, PETITIONER

v.

LOUIS C. LIEBLER, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

This memorandum is submitted pursuant to the Court's order of May 17, 1965, inviting the Solicitor General to express the views of the United States in the above case.

STATEMENT

Petitioner, a former stockholder of Fashion Park, Inc. ("Fashion Park"), brought suit for $160,293 in damages which he claimed to have suffered by reason of respondents' alleged violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder in connection with their purchase of petitioner's stock.[1] Following a trial without a jury the

[1] Section 10(b) and Rule 10b-5 are set forth in the Appendix, *infra*.

district court dismissed petitioner's complaint, and the court of appeals affirmed.

The crucial facts, as the court of appeals stated (Pet. App. 3), are "for the most part undisputed," and petitioner expressly has accepted the trial court's findings (Reply Memorandum, p. 3). Petitioner, "an experienced and successful investor," in January 1959 purchased 5100 shares of Fashion Park stock at $13.50 per share (Pet. App. 4). On November 11, 1960, he authorized his broker to sell the stock at not less than $18 a share net to him (*ibid.*). Petitioner's broker called respondent H. Hentz & Co. ("Hentz"), another broker, and offered the shares at $20; after negotiation, the stock was sold on November 17 at $18.50 per share (Pet. App. 5). Respondent Lerner, a member of the board of directors of Fashion Park, purchased 4300 of these shares; the remaining 800 were purchased by a partner in Hentz and by another partnership in which this partner was interested (*ibid.*).

None of the respondents, who include Hentz, disclosed at the time of the purchase either (1) that Lerner was a director of Fashion Park or (2) that the Fashion Park board of directors, at a meeting on November 4, 1960, which Lerner had attended, had decided to seek to sell or merge the company (Pet. App. 5–6). The board so decided following discussion with a union manager who, after threatening to withdraw a substantial number of employees from Fashion Park if he could induce another firm to settle in the same city, urged the board to consider selling the company; and, without disclosing the identity of the

potential purchaser or possible sale terms, stated that he knew of someone who might be interested in buying the company (Pet. App. 3–4).

Less than one week after respondents' purchase of petitioner's stock, negotiations were begun looking toward the acquisition of Fashion Park by Hat Corporation of America, the prospective purchaser which the union manager had by then identified (Pet. App. 4). In February 1961 a formal purchase agreement was executed, under which the purchaser would offer minority shareholders of Fashion Park $50 per share (*ibid.*). Petitioner's asserted damages are based upon the difference between this price and the $18.50 at which he sold to respondents (Pet. App. 5).

The court of appeals held that a purchaser of securities may violate Rule 10b–5 while maintaining complete silence (Pet. App. 7–8); but that in order to recover damages for such violation the seller must establish (1) that knowledge of the undisclosed facts would have "influenced [him] to act differently" (referred to by the court as "reliance") (Pet. App. 11), and (2) that "a reasonable investor" would have been influenced by the disclosure (referred to by the court as "materiality") (Pet. App. 14, 10, 12). The court of appeals upheld, as not clearly erroneous, the conclusions of the district court (1) that petitioner would have sold his stock even if he had known that the purchaser was a director of Fashion Park, *i.e.*, that there was no "reliance" upon that nondisclosure (Pet. App. 12); and (2) "that the prospects for 'a sale of Fashion Park' and for a sale at a price 'profitable to shareholders,' insofar as Lerner and the other * * *

[respondents] apprehended them to be at the time they purchased * * * [petitioner's] stock, were too remote to have influenced the conduct of a reasonable investor", *i.e.*, "that adoption of the November 4, 1960 resolution and the setting in which it occurred, were not material facts that should have been disclosed to * * * [petitioner]" (Pet. App. 13–14).[3]

DISCUSSION

This case involves the duty of disclosure which Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 of the Rules and Regulations of the Securities and Exchange Commission thereunder impose upon corporate insiders when they deal in their corporation's securities. That Section makes it unlawful for any person to employ, in connection with the purchase or sale of any security, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. Rule 10b–5, insofar as here pertinent, makes it unlawful, in connection with such purchase or sale, for any person "to employ any device, scheme, or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." The issues here involve (1) the scope

[3] The court of appeals noted that respondent Lerner had "disposed of part or all of his interest in 3137 of his 4300 shares at an average profit of only about $1 per share" within two weeks of his purchase from petitioner (Pet. App. 13). The record shows, however, that 2000 of these 3137 shares were sold to an investment company in which Lerner was the largest stockholder and that others were sold to Lerner's attorney, to employees of Lerner's own brokerage firm and to several customers of that firm (R. 210a–214a).

of the disclosure which these provisions require insiders to make before buying from minority stockholders, and (2) the extent to which the sellers, in order to recover damages resulting from the statutory violation, must show a causal connection between the non-disclosure and their decision to sell.

The issues have many ramifications, and they may arise in a wide variety of factual situations. They have become more important in recent years, since Section 10(b) and Rule 10b–5 have been relied on with increasing frequency by the Commission to prevent deceptive activities by purchasers of securities and by private parties to secure redress for such activities.[3] This Court has not yet interpreted these provisions, and a decision by it would provide helpful guideposts in the development of this important area of the law. In the present case, however, we believe that the court of appeals correctly decided the most important interpretive question, and that the case as presented to this Court primarily involves the determination of factual questions. Although the Commission believes that certain rulings of the court of appeals are erroneous, it does not believe that such rulings, if allowed to stand, would have a sufficiently significant impact upon the administration of the Securities Exchange Act to warrant our urging the Court to hear the case.

---

[3] See Fleischer, "*Federal Corporation Law*": *An Assessment*, 78 Harv. L. Rev. 1146, 1160 (1965). As to the importance of private actions as a necessary supplement to the Commission's enforcement activities, cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432.

1. The Commission believes that Rule 10b–5 requires a corporate insider, before he may purchase stock in his corporation (whether directly from the seller, or indirectly on a securities exchange or in the over-the-counter market), to disclose to the seller all information he has acquired as an insider that would be material to the seller in the sense that it might reasonably be expected to affect the investment judgment of the seller. We do not think that the court of appeals disagreed with this standard. For the court quoted with approval (Pet. App. 6–7) the following statement of the "general principles governing suits such as this" as set forth in the leading case of *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 828–829 (D. Del.), affirmed, 235 F. 2d 369 (C.A. 3):

> It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers.

Most importantly, the court held (Pet. App. 7–8) that such a duty of disclosure exists even though there is "no significant communication bearing upon value by buyer to seller except for offer, counteroffer, acceptance, or rejection." The court thus ruled that Rule 10b–5 requires a buyer to disclose material facts to a seller even though the transaction is consummated in a securities market without any direct communication between the parties; and that the buyer's duty of disclosure is not limited to situations where he

either makes a false statement or fails to disclose information which is necessary to make his statements not misleading. This ruling was plainly correct, and there is no occasion for further review thereof.

2. The point previously discussed involves the definition of the statutory violation—*i.e.*, the circumstances under which a corporate insider violates Section 10(b) and Rule 10b-5 by non-disclosure in connection with purchasing securities of his corporation from the public. Once such a violation is established, however, there is the further question of what causal connection the seller must show between the violation and his decision to sell in order to recover damages based on such violation.

At common law, neither a buyer nor a seller could recover from the other on a claim of fraud and deceit unless he could show not only that the other had made a materially false statement, but also that he had relied upon such statement to his detriment—*i.e.*, that the misrepresentation influenced him to enter into the transaction. See Prosser, *Handbook of the Law of Tort* (2d ed.) 189. Framing the test in terms of "reliance," however, is not particularly helpful when dealing with a case of complete non-disclosure. For it is difficult to see how a seller fairly can be said to have "relied" upon something he never even knew about, and this analysis leads to such confusing concepts (Pet. App. 12) as "the negative of the fact undisclosed." The appropriate inquiry, we believe, is whether the non-disclosure by the buyer caused injury to the seller.

The court of appeals enunciated the test as "whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact" (Pet. App. 11). In a case where the transaction was personally negotiated between the parties, this may be an appropriate basis for determining whether the seller was injured by the non-disclosure. But it would seem too restrictive a standard in situations where the element of personal negotiation was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market. If, for example, an insider, upon receiving information which, if made public, foreseeably would cause the market price of his company's stock to double, buys such stock before the information is disclosed, those who sell to him at the lower price are damaged, even though they still might have sold had the information been public. See, *e.g.*, *Cady, Roberts & Co.*, 40 S.E.C. 907. For in that case they would have received twice as much. In any realistic sense, therefore, they were injured by the buyer's non-disclosure, and should be permitted to recover.

It is unclear whether the standard which the court of appeals announced would permit a seller to recover in such circumstances. On the one hand, since the seller still might have sold even if he had the information, he might not come within the test that he must "have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact." On the other hand, the court might give the words "act differently" a broad meaning and hold that they comprehend selling at a different price.

With the precise scope of the decision below on this point thus unclear, there is no occasion for the Court to decide the question in this case—particularly since the petition does not appear to raise it.

3. Finally, we believe that the court of appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact. Viewed separately, perhaps neither the fact that a director wished to make a substantial purchase of Fashion Park stock nor the fact that the board of directors had resolved to attempt to sell or merge the company would have led the petitioner to refrain from selling at $18.50 a share. It might well be, however, that a stockholder would have sold his stock at a given price had he known that the purchaser was a director but not if he also had known that the board of directors had recently decided to attempt to sell or merge the company. Similarly, while the board's decision might not of itself have seemed important to an investor in deciding whether to sell his stock at the going price, it could have become important when coupled with the knowledge that one of the directors was interested in adding $80,000 worth of the company's stock to his holding. Taken in combination, therefore, these two facts might suggest to an investor—and particularly to a sophisticated investor such as the petitioner—that the director knew something more which, in his judgment as an insider, made likely an increase in the price of the stock.

We thus conclude that the court of appeals here improperly applied the governing standard for determining whether the non-disclosures were ma-

terial and injured the seller. But we do not believe that such error, if allowed to stand, would so significantly weaken the effectiveness of private damage actions as a method of enforcing Rule 10b-5 as to require review by this Court. The question turns primarily upon the facts of this particular case, and it may be that, even if the court had considered the cumulative effect of the two non-disclosures, it would have reached the same result. In any event, the petition does not appear to present this question.

Respectfully submitted.

RALPH S. SPRITZER,
Acting Solicitor General.

PHILIP A. LOOMIS, Jr.,
General Counsel,
DAVID FERBER,
Solicitor,
MICHAEL JOSEPH,
Attorney,
Securities and Exchange Commission.

AUGUST 1965.

APPENDIX

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b–5, 17 CFR 240.10b–5, promulgated by the Commission thereunder, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

U.S. GOVERNMENT PRINTING OFFICE: 1988

LIBRARY
SUPREME COURT, U. S.

No. 66

Office-Supreme Court, U.S.
FILED
SEP 3 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

ALBERT A. LIST,

Petitioner,

v.

LOUIS C. LERNER, *et al.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY TO MEMORANDUM FOR THE UNITED STATES AS *AMICUS CURIAE*

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.,
152 West 42nd Street,
New York, N. Y.

Of Counsel:
O'BRIEN, DRISCOLL & RAFTERY.

TABLE OF CONTENTS

	PAGE
The Government's view that the case although decided wrongly, should not be reviewed by this Court is unjust to petitioner, illogical, ignores the recognized importance of the issue, and is based on a clearly erroneous construction of the record	1
The Government Agrees with Petitioner's Contention That the Decision Below Was Wrong	2
The Within Case is No More Nor Less Controlled By its Facts Than Any Other Case Involving Section 10(b)	6
The Issue Here Presented is Important Enough to Require Decision by This Court	7
The Petition Did in Fact Raise the Issues Which the United States Memo Infers Were Not Raised	9
Conclusion	11

Cases Cited

In the Matter Cady, Roberts & Co., 40 S.E.C. 907 (1961)	11
J.I. Case Co. v. Borak, 377 U. S. 426 (1964)	2, 11
S.E.C. v. Capital Gains Research Bureau, 375 U. S. 180	2, 11

Supreme Court of the United States

OCTOBER TERM, 1965

ALBERT A. LIST,

Petitioner,

v.

LOUIS C. LERNER, *et al.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY TO MEMORANDUM FOR THE UNITED STATES AS *AMICUS CURIAE**

This is a reply to the U. S. memo filed herein in response to the Court's order of May 17, 1965, inviting the Solicitor General to express the views of the United States.

The Government's view that the case although decided wrongly, should not be reviewed by this Court is unjust to petitioner, illogical, ignores the recognized importance of the issue, and is based on a clearly erroneous construction of the record

General Comment. Despite the careful phrasing and a studied attempt at impartial, dispassionate analysis, the U. S. memo bring into sharp focus the fundamental issue presented by the Petition. Petitioner urges that the decision

---

* Herein referred to as "U. S. memo".

below was wrong, and the Court of Appeals should have reversed the Trial Court or at the least ordered a new trial controlled by proper legal principles. The U. S. memo agrees the decision below was wrong but appears to express a subjective impression that some other case might better lend itself to a dilineation of the admittedly important legal issue. It might have been more appropriate if the U. S. memo had said simply and unequivocably—the decision below was wrong but the Commission is waiting for a more suitable showcase. This is truly the heart of the Solicitor's argument—couched at times in the words "we believe" and at other times as "the Commission believes" to such an extent that seemingly, the Commission and the Solicitor General have differing opinions on some of the important aspects of the case.

It is interesting to note that in expressing the view which this Court sought and might reasonably have expected to be an all encompassing and objective, there is no one single mention, citation or discussion of the opinion of this Court in *S.E.C.* v. *Capital Gains Research Bureau,* despite petitioner's clear and heavy reliance thereon. This Court's opinion in *J. I. Case Company* v. *Borak* is relegated to passing reference in a footnote. It might be asked whether this is the kind of objectivity which can be expected from the Government's chief legal officer when such objective discussion was specifically requested.

The Government Agrees with Petitioner's Contention That the Decision Below Was Wrong

Agreeing with petitioner's analysis of the holding below, the U. S. memo (p. 3) concludes that the fundamental legal principles enunciated below were:

> ". . . a purchaser of securities may violate Rule 10b-5 while maintaining complete silence; but that in order to recover damages for such violation the

> seller must establish (1) that knowledge of the undisclosed facts would have 'influenced [him] to act differently' (referred to by the court as 'reliance') and (2) that 'a reasonable investor' would have been influenced by the disclosure (referred to by the court as 'materiality')."

In asserting, however (at p. 5) that the Court of Appeals correctly decided the most important interpretive issue, the U. S. memo begs the question. True, the Court of Appeals may have paid lip service to the general principle which compels disclosure by a corporate insider of all information he has acquired before purchasing stock in his corporation. It was in the application, however, of that general principle to the case at bar that the court below erred—and this is conceded in the U. S. memo.

It is not merely enough to state the obvious—i.e., disclosure was required by respondents. That the Court below did so state does not cure the vice inherent in the decision. The U. S. memo states clearly—as petitioner contends—

> ". . . the court of appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact." (p. 9)
>
> • • • • • • •
>
> "We thus conclude that the court of appeals here improperly applied the governing standard for determining whether the non-disclosures were material and injured the seller." (pp. 9-10)

Moreover, as the U. S. memo says of an integral part of the decision below:

> "Framing the test in terms of 'reliance,' however, is not particularly helpful when dealing with a case of

complete non-disclosure. For it is difficult to see how a seller fairly can be said to have 'relied' upon something he never even knew about, and this analysis leads to such confusing concepts as 'the negative of the fact undisclosed.' The appropriate inquiry, we believe, is whether the non-disclosure by the buyer caused injury to the seller. (p. 7)

"The court of appeals enunciated the test as 'whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact'.

In a case where the transaction was personally negotiated between the parties, this may be an appropriate basis for determining whether the seller was injured by the non-disclosure. But it would seem too restrictive a standard in situations where the element of personal negotiations was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market. * * * It is unclear whether the standard which the court of appeals announced would permit a seller to recover in such circumstances." (p. 8)

Thus the U. S. memo agrees with petitioner that the Court below erred in the two most significant areas presented to it for decision.

In summary, therefore,

A. The U. S. agrees disclosure was required by the respondents of something (U. S. memo, pp. 6-7).

B. Standing alone, a requirement of disclosure is meaningless. As the U. S. memo says (p. 7):

"Once such a violation is established, however, there is the further question of what causal connection the seller must show between the violation and his decision to sell in order to recover damages based on such violation."

Consequently, it is the sheerest sophistry to argue as does the U. S. memo (p. 5) that—

> "the case as presented to this court primarily involves the determination of factual questions".

C. The Court below did not follow these proper principles in answering the very questions which the existence of a situation involving the general duty of disclosure requires be answered.

> Question 1—What the seller must show in order to recover damages based on a conceded violation. The memo says, the test of 'reliance' used by the court below is not proper, the appropriate inquiry is injury (p. 7).

As to this, no matter how the U. S. memo tries to excuse the decision below, it must and *in fact does conclude* with regard to the test enunciated by the Court of Appeals (pp. 7-8);

> "framing the test in terms of 'reliance', however, is not particularly helpful when dealing with a case of complete non-disclosure. * * * it would seem too restrictive a standard in situations where the element of personal negotiation was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market."

Accepting the Government's view of the proper nature of the inquiry—*Was petitioner injured?* we agree with the Government's conclusion that "In any realistic sense, therefore, they were injured by the buyer's nondisclosure and should be permitted to recover" (p. 8).

> Question 2—Should each non-disclosure be viewed separately or cumulatively, and in combination. As

> to this, the U. S. memo concedes—"we believe that the Court of Appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact" (p. 9).

Despite the inescapable conclusion which the Solicitor General's own logic compels that he reach and which he does reach, albeit reluctantly, viz. the decision below was wrong—he nevertheless suggests the case at bar is not an appropriate one for this Court to entertain.

This advice is predicated on three premises, all demonstrably erroneous: 1) The case is limited to its peculiar facts; 2) the case is not important; and 3) the Petition may not have raised the key questions.

The Within Case is No More Nor Less Controlled By its Facts Than Any Other Case Involving Section 10(b).

As the U. S. memo says (p. 5):

> "The issues have many ramifications, and they may arise in a wide variety of factual situations."

This statement is inconsistent, however, with the later expressed view of the memo that because the case involves factual matters, this Court should not grant certiorari. As the Government so obviously recognized, every case arising under Section 10(b) involves varying facts. It is petitioner's contention that guide lines ought to be set and set now by the Supreme Court to control the future cases which arise under widely varying facts and of which there have recently been a proliferation.

The Issue Here Presented is Important Enough to Require Decision by This Court.

As the U. S. memo says of the issues here involved (p. 5):

> "They have become more important in recent years, since Section 10(b) and Rule 10b-5 have been relied on with increasing frequency by the Commission to prevent deceptive activities by purchasers of securities and by private parties to secure redress for such activities. This Court has not yet interpreted these provisions, and a decision by it would provide helpful guideposts in the development of this important area of the law."

The Government also recognizes that the issue here presented has "many ramifications".

The importance of a decision in this case to the investing public and securities experts generally, is apparent from a recent article which appeared on the first page of the Wall Street Journal for July 14, 1965, wherein it is said among other things:

> "It's true, that neither Rule 10B-5 nor its underlying securities law makes any specific provision for private suits to recover damages. But in recent years the rule and the law have begun to acquire the courts precedents needed to make them potent weapons in the hands of disgruntled investors. Among other things, a 1964 Supreme Court decision is giving encouragement to the stockholder cause.
>
> • • • •
>
> "Until now, 10B-5 has been a sleeping giant; we haven't known how far the courts will go in applying the fair standards for securities transactions set by the SEC • • •.
>
> "Especially important to angry stockholders is a series of Federal Court decisions which gradually have been

> clearing away the thicket of legal uncertainty surrounding the use of Rule 10B-5 in private suits.
>
> • • • •
>
> "Currently there's special interest among securities law experts in the possibility of a High Court ruling in a suit titled *List* v. *Fashion Park, Inc., et al.*, a case that directly involves Rule 10B-5."

The importance of the case is even more graphically demonstrated by an article beginning at page 29 of the August 6th issue of LIFE which is captioned: "SEC v. Texas Gulf Raises Sticky Questions." In the article the author says of the *Texas Gulf Sulphur* case, which is bottomed on the same statute involved and involves the same principle and theory as the within action:

> "The issues in the suit go right to the heart of one of the thorniest ethical questions in the field of investment; to what extent should a businessman be allowed to profit, in private stockmarket dealings, from knowledge of a company's affairs which he has and outside investors do not."

This is prescisely the question presented by the within petition.

Clearly, whether or not the Solicitor General and the Commission are aware of it, the investing public and authors in the field realize the significance and importance of the issue presented by this petition.

That there may be indeed some difference of opinion as between the Solicitor General and the staff of the Commission may be inferred from the use in the U. S. memo at the bottom of page 5 of the expression "the Commission believes", whereas in the immediately preceding sentence and elsewhere throughout the memo appears the expression "we believe". This is a significant difference because in the very sentence in which the reference is made to the

beliefs of the Commission as distinguished from those of the United States, appears the further expression—"it does not believe that [the erroneous rulings of the Court of Appeals] if allowed to stand would have a sufficiently significant impact upon the administration of the Securities Exchange Act." The "it" refers to the Commission.

Whether or not the decision below might have a significant effect on the administration of the Securities Exchange Act *by the Commission* is not the sole issue as demonstrated from the avid interest of commentators referred to above. In addition, the investing public, financial commentators, securities law experts and the public generally, are vitally concerned with and interested by the issue which this case raises. An early decision by this Court would go far to settle the uncertainty which according to the Wall Street Journal and Life has already given birth to "a flurry of stockholder suits."

The Petition Did in Fact Raise the Issues Which the United States Memo Infers Were Not Raised

Although agreeing with petitioner that the "court of appeals here improperly applied the governing standard for determining whether the non-disclosures were material and injured the seller" the U. S. memo at two places (pp. 9 and 10) suggests that the Petition failed to contend that petitioner would not have sold if he had the information which concededly the respondents were required to disclose. This suggestion in the U. S. memo is absolutely incorrect. The Petition clearly and undeniably raises the point. Thus at page 8 of the Petition appears the following assignment of error:

> "The Court of Appeals erred in adopting the Trial Court's finding (1) That List would have sold even if he had the information that one of the buyers was a director of Fashion Park, and (2) that the undisclosed

resolution that Fashion Park be sold or merged was not a material fact (269a)."

Petitioner testified (pp. 56a and 57a of Appendix of main brief in the court below):

"Q. You did know that Mr. Lerner was a director of Fashion Park, didn't you? A. Yes.

Q. You got that from the reports of the company, didn't you? A. That's right, yes.

• • • •

(288) Q. At the time that you agreed to sell your stock on or about the 17th day of November, were you familiar in any way with that resolution of November 4th? A. No, I was not.

Q. Had you been informed by anybody that such a resolution to sell or merge the company had been adopted by the board of directors on November 4th? A. I had not.

Q. Now, Mr. List, if you had known that Mr. Lerner was one of the potential buyers of your block of stock, at the time that you sold—that you agreed to sell, would you have agreed to sell your stock at $18, or at 18.50?

• • • •

A. I would not have sold the stock.

• • • •

Q. If you had known that a member of the board of directors of Fashion Park, Inc. was the potential (289) buyer of all or part of that block of stock, would you have consented to its sale for $18.50?

• • • •

A. I would not have sold my stock.

Q. If you had known that at the time—if you had known on November 17th, when you agreed to sell your block of stock at $18.50, that prior thereto and on

November 4 a resolution had been adopted by the board of directors of Fashion Park, unanimously adopted, to merge or sell the company, would you have agreed to sell your stock at $18.50 a share?

* * * *

A. I would not.

* * * *

A. I would not have sold my stock.

Q. Now, if you had known on November 17th, when you agreed to sell your stock at $18.50, that a partner of Hentz & Company, stock brokers, was buying part of that stock, would you have agreed to sell your stock for $18.50 a share?

* * * *

(290) Q. Would you have sold your stock? Should I repeat the question to you? A. No. If it was pointed out to me that a partner in the firm was personally purchasing the stock, I would not sell it."

There was not one single bit of testimony or one scrap of evidence to contradict petitioner's testimony; and assuming *arguendo* that there was a finding that petitioner might still have sold had he known the undisclosed facts, this finding was without any support whatsoever in the record and was clearly erroneous.

Conclusion

The writ should be granted for the following reasons:

1. The decision below is in conflict with the purposes of the Federal securities laws and the canons of construction of these laws as set forth by this Court in its *Borak* decision and in its *Capital Gains Research* decision and by the Commission in the *Cady, Roberts* release.

2. The decision below affects an area of securities transactions of increasingly great financial importance and of frequent occurrence. There is substantial conflict in principle between the decision below and the decision in other circuits as well as the decisions of this court.

3. A decision by this Court is needed to clarify the purposes of the Federal securities laws and the import of the language of Rule 10b-5.

4. To permit a clearly erroneous decision to stand unchanged denies petitioner his equal rights under law and makes a mockery of the administration of justice.

Respectfully submitted,

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.

Of Counsel:
O'BRIEN, DRISCOLL & RAFTERY,

September 1965.

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
NOV 5 1965
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

No. 66

ALBERT A. LIST, Petitioner,

v.

LOUIS C. LERNER, *et al.*

PETITION FOR REHEARING

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.,
152 West 42nd Street,
New York, N. Y.

Of Counsel:
O'BRIEN, DRISCOLL & RAFTERY.

TABLE OF CONTENTS

PAGE

POINT I—Events have occurred since the denial of the writ which clearly takes this case outside the general rules which govern this Court in the granting or denial of certiorari in the ordinary case 2

POINT II—Lerner's conduct as an insider director completely disregarded the SEC Acts and Rules 4

POINT III—This Court granted certiorari in *Securities and Exchange Commission* v. *Capital Gains Research Bureaus*, 375 U. S. 180 4

Conclusion 6

TABLE OF CASES

Altoona Publix Theatres v. American Tri-Ergon, 293 U. S. 528, 79 L. ed. 638 2

Paramount Publix Corp. v. American Tri-Ergon, 293 U. S. 528, 79 L. ed. 638 2

Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U. S. 180 ..... 4, 6

Wilmer & Vincent v. American Tri-Ergon, 293 U. S. 528, 79 L. ed. 638 2

INDEX TO APPENDIX

PAGE

Order for Private Proceedings Pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 66

ALBERT A. LIST,

Petitioner,

v.

LOUIS C. LERNER, *et al.*

PETITION FOR REHEARING

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

A petition for a writ of certiorari herein was denied by this Court on October 11, 1965. The petition had been docketed March 30, 1965 as No. 1027 October Term, 1964.

In an order entered May 17, 1965 the Court invited the Solicitor General to file a brief expressing the views of the United States in this case.

The requested memorandum was filed before August 16, 1965.

In this memorandum the Government's counsel, although conceding the many errors made by the District Court and the Court of Appeals, nevertheless expressed the opinion that the Court ought not to grant certiorari.

POINT I

Events have occurred since the denial of the writ which clearly takes this case outside the general rules which govern this Court in the granting or denial of certiorari in the ordinary case.

Occurrence after the denial of a petition of new facts, justifies re-examination of the application.

> *Paramount Publix Corp.* v. *American Tri-Ergon,* 293 U. S. 528, 79 L. ed. 638;
> *Altoona Publix Theatres* v. *American Tri-Ergon,* 293 U. S. 528, 79 L. ed. 638;
> *Wilmer & Vincent* v. *American Tri-Ergon,* 293 U. S. 528, 79 L. ed. 638.

On October 13, 1965 petitioner's counsel first learned of the new facts above referred to when he received copies of the documents in the appendix annexed hereto.

Prior to August 11, 1965, the Securities and Exchange Commission filed a proceeding (File 3-268) against Louis Lerner, one of the principal defendants in this case, which resulted in an order being entered August 16, 1965 suspending Lerner and his corporation for five days for the offenses charged and set out in the appendix to this brief. It is to be noted that the offenses with which Lerner is there charged involving transactions in the stock of Maxson Electronics Corp., are identical to the charges made by petitioner herein regarding Fashion Park's stock.

The consent private order in the Maxson proceeding did not become a matter of public record until October 7, 1965, although entered August 16, 1965.

It was just prior to August 16th that the Acting Solicitor General filed the Government's memorandum in this case. It was not disclosed to this Court in said memorandum that

at the very time it was being filed the SEC had pending a proceeding charging Lerner with wilfully violating Sections 10-b and 15(c)(1) of the Securities Exchange Act of 1934 and Rules 10b-5 and 15(c)-1-2 thereunder in connection with transactions in Maxson Electronics Corp. of the very type he was charged with in this case in Fashion Park Corporation stock.

The Government's memorandum herein should have included a reference to the pendency of the administrative proceeding against Lerner in Maxson. Had this been done, the Court would have been made aware of the fact that the SEC was considering charges against Lerner at or about the same time the Government was preparing the memorandum herein based on an identical pattern of non-disclosures.

In the instant case, Lerner and his relatives, friends, broker and family deprived List of a sum in excess of $162,000 plus interest.

Would this Court have denied certiorari in the instant case if it had known of the pendency of an administrative proceeding against the same Lerner by the Commission involving another company, and that in fact an order had been entered proscribing Lerner's conduct but publication of the order held up?

Lerner's conduct as an inside director in both the Maxson case and the Fashion Park case was identical. He was a director of both companies. He attended the meeting of directors of Fashion Park on November 4, 1960 and actually participated in the passage of the resolution to sell or merge the business, creating a complete change of business. He had inside knowledge in the Maxson case of the favorable Government contract, and made purchases based on his inside knowledge.

In the Maxson proceeding, the majority of Lerner's purchases were for the accounts of relatives prior to the

public disclosure of Maxson's favorable Government contracts, while in the instant case Lerner allocated 800 shares to his broker Green and Green's family and 4,300 shares to relatives and friends and a security company that he controlled.

POINT II

Lerner's conduct as an insider director completely disregarded the SEC Acts and Rules.

Lerner's action in the Maxson case was identical to his course of conduct in the Fashion Park case.

Lerner was a director of Fashion Park and also of Maxson.

Lerner attended the meeting of directors of Fashion Park on November 4, 1960 and participated in the passage of the resolution to sell or merge the business creating a complete change of position.

Lerner made no disclosures of his inside knowledge either in the Maxson case or the Fashion Park case.

POINT III

This Court granted certiorari in *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U. S. 180.

In the Capital Gains case, the Second Circuit Court of Appeals on the reargument sat *in banc*. Judge Moore wrote the majority opinion, concurred in by Judges Lumbard, Waterman, Friendly and Hays, 306 F. 2d 607. The minority opinion was written by Chief Judge Clark, concurred in by Judges Marshall, Kaufman and Smith, page 611. C. J. Clark opened his dissent with the following:

> "Decision in the present case turns on the meaning and scope of the Investment Advisers Act of 1940,

last of the six great regulatory statutes of the era 1933-1940 controlling the marketing of investment securities. We need to recall the dramatic origin of these statutes as an outcome of the greatest stock market crash in history and the exhaustive studies then made of the evils of stock market manipulation and fraudulent stock selling. It seems universally conceded—and the favorable judicial attitude records the fact—that this legislation was brilliantly successful in responding to a genuine social need. It is a prime demonstration of the capacity of a democratic government to meet a social crisis skillfully and positively. While it may not have solved every problem, it went a long way in facing the issues involved and protecting the investor from being victimized."

Judge Clark then continues at page 612 criticizing the majority opinion as follows:

> "After this history of successful achievement it comes as a real shock to find a majority of this court ready to scuttle the last of these highly useful statutes and leave it as but a shell."

On page 614 Judge Clark continues:

> "These statutes form an interrelated pattern of regulation of the securities industry, all of which are essential for the adequate protection of the investor."

Judge Clark's dissent both in the previous sentence and in many sentences thereafter makes it crystal clear that the laws were passed primarily to protect the public against investors like Lerner.

Continuing Judge Clark's opinion:

> "One of the chief methods of regulation followed in the several acts was the requirement of full disclosure. In contrast to the common law, which was premised on the ancient *maxim caveat emptor*, the

regulatory legislation adopted the philosophy of consumer protection, 'let the seller also beware.' "

This dissent was upheld by the U. S. Supreme Court in *Securities and Exchange Commission* v. *Capital Gains*, 375 U. S. 180, Justice Goldberg writing the opinion.

CONCLUSION

For all of the grounds herein stated, it is respectfully submitted that this petition for a rehearing of petitioner's application for a writ of certiorari should be granted and the motion for certiorari should likewise be granted.

Respectfully submitted,

ARTHUR F. DRISCOLL,
EDWARD C. RAFTERY,
MILTON M. ROSENBLOOM,
EDMUND C. GRAINGER, JR.

Of Counsel,

O'BRIEN, DRISCOLL & RAFTERY.

I hereby certify that the foregoing petition is presented in good faith and not for delay.

EDWARD C. RAFTERY.

APPENDIX

Order for Private Proceedings Pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934.

ADMINISTRATIVE PROCEEDING
FILE NO. 3-268

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

August 16, 1965

In the Matter of

LERNER & CO., INC. (8-9111)
LOUIS C. LERNER

I

The Commision's public official files discloses that:

A. Lerner & Co., Inc. a Massachusetts corporation with offices at 10 Post Office Square, Boston, hereinafter referred to as registrant, became registered as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934 on December 15, 1960 and is still so registered.

B. Louis C. Lerner has been the president and a director of registrant and the owner of 10% or more of registrant's common stock since November 23, 1960.

C. Registrant is a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the Securities Exchange Act of 1934.

D. Registrant is a member, within the meaning of Section 3(a)(3) of the Securities Exchange Act of 1934, of the American Stock Exchange, a national securities exchange registered pursuant to Section 6 of the Securities Exchange Act of 1934.

E. The common stock of Maxson Electronics Corp. is listed on the American Stock Exchange.

II

As a result of an investigation, the Division of Trading and Markets has obtained information which tends to show and it alleges that:

During the period from about June 18, 1964 to about June 19, 1964, registrant and Louis C. Lerner, hereinafter referred to as respondents, singly and in concert, wilfully violated and wilfully aided and abetted violations of Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 and Rules 10b-5 and 15c1-2 thereunder in that respondents, in connection with the purchase of and in effecting transactions in the securities of Maxson Electronics Corp. (Maxson), directly and indirectly, employed devices, schemes and artifices to defraud, made untrue statements of material facts and omitted to state material facts necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, and engaged in acts, practices and courses of business which would and did operate as a fraud and deceit upon sellers and prospective sellers of Maxson securities. Said conduct and activities occurred as follows:

A. Louis C. Lerner is a director of Maxson.

B. On or about June 11, 1964, Louis C. Lerner learned that Maxson Electronics Corp. was the low bidder on a contract to be awarded by the Navy Department to manu-

facture missiles and had been invited to the Navy Department's Washington, D. C. offices for the purposes of negotiating such contract. On or about June 19, 1964, Louis C. Lerner learned that William C. Maxson, the president of Maxson, had executed the contract on behalf of the company. On June 22, 1964 an article appeared in the Scranton Times, a Pennsylvania newspaper, which stated that Maxson had been awarded a very substantial contract to manufacture missiles for the Navy. On June 23, 1964 at approximately 12:50 p.m. the news of the contract award to Maxson was made public via the Dow Jones wire service.

C. In the period from about June 18, 1964 to about June 19, 1964, respondents with knowledge of the non-public material corporate information mentioned in paragraph B hereof solicited purchases and executed purchases for accounts at registrant in the common stock of Maxson. The majority of these purchases were for the accounts of relatives of the respondents. All of said purchases were caused by respondents to be executed on the American Stock Exchange prior to the public disclosure of such information and without disclosing such information to the sellers of such shares.

III

In view of the allegations made by the Division of Trading and Markets, the Commission deems it necessary and appropriate in the public interest and for the protection of investors that private proceedings be instituted to determine:

(a) whether the allegations set forth in Section II are true, and in connection therewith to afford respondents an opportunity to establish any defenses to such allegations; and

(b) what, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act.

IV

IT IS HEREBY ORDERED that a private hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held at a time and place to be fixed and before a hearing examiner to be designated by a further order as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that each party file an answer to the allegations contained in the order for proceeding within 15 days after service upon him of said order as provided by Rule 7 of the Commission's Rules of Practice.

If any party fails to file the directed answer or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceedings may be determined against such party upon consideration of such order for proceedings, the allegations of which may be deemed to be true.

This order shall be served upon Lerner & Co., Inc. and Louis C. Lerner personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision upon this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that section delaying the effective date of any final Commission action.

By the Commission.

ORVAL L. DUBOIS,
Secretary.

Appendix.

Findings, Opinion and Order Suspending Broker-Dealer Registration and Membership on National Securities Exchange.

(Securities Exchange Act Release No. 7721)

ADMINISTRATIVE PROCEEDING
FILE NO. 3-268

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
October 7, 1965

In the Matter of

LERNER & CO., INC.
10 Post Office Square
Boston, Massachusetts

and

LOUIS C. LERNER

(8-9111)

Securities Exchange Act of 1934—
Sections 15(b), 15A and 19(a)(3)

In these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Act"), the order for proceedings alleges that Lerner & Co., Inc. ("registrant") and Louis C. Lerner, president and a director and principal stockholder of registrant, wilfully violated Sections 10(b) and 15(c) of the Act in connection with purchases on or about June 18 and 19, 1964, of shares of Maxson Electronics Corp. ("Maxson"), of which Lerner was a director. The order for proceedings further alleges that after respondents learned that Maxson

was negotiating for and had been awarded a substantial defense contract, and prior to public disclosure of such material information, registrant, without disclosing such information to sellers, solicited and executed purchases of Maxson shares, the majority of which were for the accounts of relatives of Lerner.

Registrant and Lerner have entered into stipulations and consents in which they waive a hearing and post-hearing procedures. In addition, without admitting or denying the allegations in the order for proceedings, registrant consents to the entry of an order suspending its broker-dealer registration and its membership on the American Stock Exchange for a period of not more than five business days, and Lerner consents to the entry of an order pursuant to Section 15(b)(7) of the Act suspending him from being associated with a broker-dealer for the same period. The Commission, on the recommendation of its Division of Trading and Markets, has determined to accept these stipulations and consents.

On the basis of the order for proceedings and the stipulations and consents, it is found that it is in the public interest to suspend registrant's broker-dealer registration and its membership in the American Stock Exchange for a period of five business days and to suspend Lerner from being associated with any broker-dealer for a like period.

Accordingly, IT IS ORDERED that the registration as a broker and dealer and the membership in the American Stock Exchange of Lerner & Co., Inc. be, and they hereby are, suspended for five business days and that Louis C. Lerner be, and he hereby is, suspended from being associated with any broker-dealer for the same period, such suspensions to begin at the opening of business on October 11, 1965.

For the Commission (pursuant to delegated authority).

ORVAL L. DUBOIS,
Secretary.